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No. 69-276

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

RAYMOND L. DIRKS,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The District Of Columbia Circuit

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED AUGUST 17, 1962
CERTIORARI GRANTED NOVEMBER 15, 1962

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D.C.

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These following items are contained in the Appendix to the Petition for a Writ of Certiorari and are incorporated in the Joint Appendix by reference:

OPINION AND ORDER OF THE SECURITIES AND EXCHANGE COMMISSION, DATED JANUARY 22, 1981

JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT, DATED MARCH 29, 1982

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT, DATED MAY 18, 1982

ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT DENYING PETITION FOR REHEARING, DATED MAY 19, 1982

ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT DENYING REHEARING *EN BANC*, DATED MAY 19, 1982

LIST OF RELEVANT HEARINGS HELD, PLEADINGS FILED, AND ORDERS ENTERED BY AND BEFORE THE SECURITIES AND EXCHANGE COMMISSION

(*In Re* The Boston Company Institutional Investors, Inc., John W. Bristol & Co., Inc., Raymond L. Dirks, The Dreyfus Corporation, Manning & Napier, and Tomlin, Zimmerman & Parmelee, Inc. Administrative Proceeding No. 3-5068)

August 24, 1976 Order for public proceedings before the Securities and Exchange Commission filed

September 10, 1976 Order amending Order for public proceedings to add Dreyfus Corp. as a respondent entered

October 8, 1976 Answer of Respondent Dirks filed

December 2, 1976; January 31-February 4, 1977; February 7-9, 15-17, 22-24, and 28, 1977; March 2, 9-10, 14-17, 21, 24, and 29-31, 1977; April 1, 1977; June 27-July 1, 1977; July 11-15, 18-21, 25-26, and 28, 1977; August 22-24 and 29-31, 1977; September 1, 2, and 6, 1977 Hearings Before Administrative Law Judge David Markun

March 28, 1977 Statement of the Division of Enforcement's theories of law filed

November 25, 1977 Proposed Findings of Fact and Conclusions of Law of the Division of Enforcement filed

November 25, 1977 Memorandum of the Division of Enforcement in support of its Proposed Findings and Conclusions filed

March 15, 1978 Respondents' Joint Proposed Findings of Fact and Conclusions of Law filed

March 15, 1978 Proposed Findings of Fact, Conclusions of Law and Objections of Respondent Dirks filed

March 16, 1978 Memorandum of Law for Respondent Dirks filed

March 17, 1978 Respondents' Joint Memorandum in Support of their Proposed Findings of Fact and Conclusions of Law filed

April 12, 1978 Notice of supplemental authority of Respondent Dirks filed

April 21, 1978 Respondent Dirks' Supplemental Memorandum on the issue of sanctions filed

May 22, 1978 Reply Memorandum of the Division of Enforcement filed

May 22, 1978 Objections to Respondents' Proposed Findings of Fact and replies to Respondents' Objections to Division's Proposed Findings of Fact filed by the Division of Enforcement

June 14, 1978 Letter to Judge Markun from Donald Malawsky of the Division of Enforcement concerning recent court decisions

June 26, 1978 Letter to Judge Markun from Messrs. Bonderman and Hird, counsel for Respondent Dirks, concerning recent court decisions

September 1, 1978 Initial Decision of Judge Markun entered

October 2, 1978 Respondent Dirks' Petition for review by the Commission filed

October 12, 1978 Order granting Petitions for review filed by Respondent Dirks and the Division of Enforcement entered

October 17, 1978 Order giving notice that the Initial Decision of the Administrative Law Judge became final as to all Respondents other than Respondent Dirks entered

November 20, 1978 Memorandum in support of the Division of Enforcement's Petition for Review filed

January 3, 1979 Memorandum in support of Respondent Dirks' Petition for Review and in Opposition to the Division's Petition filed

March 6, 1979 Reply Memorandum of the Division of Enforcement filed

April 6, 1979 Reply Memorandum of Respondent Dirks filed

June 13, 1979 Oral Argument Before Securities and Exchange Commission

May 30, 1980 Notice of supplemental authority of Respondent Dirks filed

June 11, 1980 Reply of the Division of Enforcement to Respondent Dirks' Notice of supplemental authority filed

June 26, 1980 Second Notice of supplemental authority of Respondent Dirks filed

June 26, 1980 Response of Respondent Dirks to reply to the Notice of supplemental authority filed

July 8, 1980 Reply of the Division of Enforcement to Respondent Dirks' second Notice of supplemental authority filed

August 7, 1980 Response to Division's reply to Dirks' second Notice of supplemental authority filed

January 22, 1981 Opinion and Order of the Commission censuring Respondent Dirks entered

February 10, 1981 Application of Respondent Dirks for stay of Order pending appeal filed

February 11, 1981 Order staying imposition of censure pending appeal entered

February 23, 1981 Memorandum of Law of the Division of Enforcement in Opposition to Respondent Dirks' Motion for a Stay filed

RELEVANT DOCKET ENTRIES IN THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

(Raymond L. Dirks v. Securities and Exchange Commission, No. 80-1243)

DATE	FILINGS — PROCEEDINGS
(V)03-05-81	4-Petitioner's petition for review of an order of the SEC (m-5)
(T)04-27-81	Certified Index to Record (n-2)
(V)07-10-81	4-Petitioner's brief (p-10)
(V)09-09-81	4-Respondent's brief (m-1)
(V)10-06-81	3-Petitioner's reply brief (p-6)
(V)10-06-81	7-Joint appendix - volumes I & II (p-6)
(V)11-02-81	15-Respondent's brief (m-20); withdrawn per 12/15/81 order
(C)12-15-81	15-SEC's corrected brief (m-24)
(B)01-07-82	Argued before Wright, Tamm and Robb, CJs
(C)01-27-82	4-Letter from counsel for SEC advising of additional authorities pursuant to FRAP 28(j) (m-27)
(V)02-03-82	4-Letter from counsel for petitioner advising of additional authorities pursuant to FRAP 28(j) (m-3)
(V)02-17-82	4-Letter from counsel for petitioner advising of additional authorities pursuant to FRAP 28(j) (m-16)
(V)03-09-82	4-Letter from counsel for SEC in response to petitioner's letter pursuant to FRAP 28(j) (m-4) (OK,RAB)
(S)03-29-82	Judgment that the order of the SEC is affirmed; no opinion or memo

DATE	FILINGS—PROCEEDINGS

(C)04-27-82 15-Petitioner's petition for rehearing and suggestion for rehearing en banc (m-27)

(S)05-18-82 Opinion for the Court filed by CJ Wright

(S)05-18-82 Standard order on mandate

(V)05-19-82 Per Curiam order, en banc, that petitioner's suggestion for rehearing en banc is denied; CJ Robinson, Wright, Tamm, MacKinnon, Robb, Wilkey, Wald, Mikva, Edwards, Ginsburg and Bork, CJs (MacKinnon, Wald and Mikva, CJs did not participate in the foregoing order)

(V)05-19-82 Per Curiam order that petitioner's petition for rehearing filed April 27, 1982 is denied; Wright, Tamm and Robb, CJs

(S)05-26-82 Certified copy of judgment and of opinion issued to SEC

(C)08-20-82 Notice from Clerk, SC that petition for writ of certiorari was filed in SC No. 82-276 on Aug. 17, 1982

(T)11-16-82 Certified copy of order from Clerk, Supreme Court granting petition for writ of certiorari in SC No. 82-276 on 11-15-82

ADMINISTRATIVE PROCEEDING
FILE NO. 3-5068

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

August 24, 1976

In the Matter of

BOSTON COMPANY INSTITUTIONAL
INVESTORS, INC.
(801-6829)

JOHN W. BRISTOL & CO., INC.
(801-4726)

RAYMOND L. DIRKS

DREYFUS SPECIAL INCOME FUND, INC.
(811-2209)

MANNING & NAPIER
(801-6611)

TOMLIN, ZIMMERMAN & PARMELEE, INC.
(801-8853)

ORDER FOR PUBLIC PROCEEDINGS PURSUANT TO SECTION 15(b) AND 19(h) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940

I

The Commission's public official files disclose that:

A. The Boston Company Institutional Investors, Inc. ("III") has, at all times since August 24, 1970, been registered

with the Commission as an investment adviser. III's principal place of business is One Boston Place, Boston, Massachusetts 02108.

B. John W. Bristol & Co., Inc. ("Bristol Co.") has, at all times since February 28, 1968, been registered with the Commission as an investment adviser. Bristol Co.'s principal place of business is 233 Broadway, New York, New York 10007.

C. The Dreyfus Special Income Fund, Inc. ("Dreyfus") has, at all times since July 1971, been registered with the Commission as an investment company. Its principal place of business is 767 Fifth Avenue, New York, New York 10022.

D. Manning & Napier has, at all times since May of 1970, been registered with the Commission as an investment adviser. Its principal place of business is One East Avenue, Rochester, New York 14604.

E. Tomlin, Zimmerman & Parmelee, Inc. ("TZP") has, at all times since September 1972, been registered with the Commission as an investment adviser. TZP's principal place of business is 1133 Avenue of the Americas, New York, New York 10036.

II

As the result of an investigation ordered by the Commission, the Division of Enforcement alleges that:

A. In March of 1973 Raymond L. Dirks ("Dirks") was a security analyst specializing in the insurance industry. At that time, Dirks was associated with a broker-dealer registered with the Commission and a member of the New York Stock Exchange ("NYSE") and other national exchanges. He is currently employed in the securities industry.

B. From 1960 to 1966 Equity Funding Corporation of America ("Equity Funding") was essentially a marketing organization selling life insurance, shares in mutual funds, and funding programs combining the two. In 1967 Equity Funding embarked on a diversification program which included the

acquisition of various companies, and by 1970 Equity Funding's subsidiaries were engaged in a variety of business enterprises that included mutual funds, insurance companies, marketing companies, a savings and loan association, certain foreign operations, partnerships in oil and gas exploration and cattle breeding, and a real estate development enterprise.

C. Equity Funding first issued its securities to the public in 1964. Pursuant to a registration statement filed with the Commission, 100,000 common shares were offered and sold at $6 per share.

D. In 1965 Equity Funding issued $2,000,000 of 5½% capital subordinated notes due in 1980 with common stock purchase warrants, pursuant to a registration statement filed with the Commission.

E. In 1967 Equity Funding issued $6,000,000 of 5½% convertible debentures due in 1982, pursuant to a registration statement filed with the Commission.

F. In 1968 Equity Funding issued $15,000,000 of 5½% convertible subordinated debentures due in 1983, pursuant to a registration statement filed with the Commission.

G. In 1970 Equity Funding issued $22,000,000 of 9½% debentures due in 1990, with common stock purchase warrants, pursuant to a registration statement filed with the Commission.

H. In 1971 Equity Funding issued $38,000,000 of 5½% convertible subordinated debentures due in 1991, pursuant to a registration statement filed with the Commission.

I. From 1964 to about March 1973, Equity Funding filed periodic reports with the Commission pursuant to the Exchange Act.

J. During March of 1973 and prior thereto, Equity Funding common shares and the 5½% convertible subordinated debentures due in 1991 ("the debentures") were listed and traded on the NYSE. Equity Funding warrants were listed and traded on the American Stock Exchange.

K. For the week ending March 9, 1973, Equity Funding common shares traded on the NYSE at a high of $28⅜ and a low of $25⅝, with average daily volume of 9,860 shares, closing at $28. For the same week, the debentures traded at a high of $91 and a low of $89½, on average daily volume of 17 bonds. From March 12, 1973 to March 27, 1973, Equity Funding's common stock and debentures were traded on the NYSE approximately as follows:

EQUITY FUNDING CORP. OF AMERICA

COMMON SHARES DAILY TRADING

Date	Low	High	Volume
3-12-73	27½	28⅜	33,700
3-13-73	27¼	27⅝	14,300
3-14-73	27	27⅜	15,000
3-15-73	25½	26⅞	45,300
3-16-73	25	25⅝	10,700
3-19-73	23	25	123,800
3-20-73	23⅛	23½	14,400
3-21-73	19¼	23⅛	524,000
3-22-73	19¾	20¼	59,600
3-23-73	18⅞	20¼	113,700
3-26-73	16⅝	19¾	768,400
3-27-73	14⅜	17½	307,200

(trading suspended 3-27-73)

5½ CONVERTIBLE SUBORDINATED DEBENTURES 1991

WEEKLY TRADING

Week Ending	Low	High	Volume
3-16-73	90	93	114
3-23-73	75	85	273
3-30-73	67	75⅛	552

(trading suspended 3-27-73)

L. At or about 12:45 p.m. on March 27, 1973, the New York Stock Exchange suspended trading in Equity Funding securities.

M. On March 28, 1973 the Commission suspended all trading in the securities of Equity Funding.

N. On April 2, 1973, the Commission filed a civil injunctive action in the United States District Court, Central District of California, against Equity Funding, alleging violations of the antifraud and reporting provisions of the Exchange Act and rules thereunder. On April 3, 1973, a judgment of permanent injunction on consent was entered against Equity Funding.

O. On April 5, 1973 Equity Funding filed a petition under Chapter X of the Bankruptcy Act which was approved by the U.S. District Court on April 6, 1973, effective April 5, 1973. On or about April 10, 1973, that court appointed a trustee for Equity Funding.

P. After conducting an investigation, the trustee reported to the court that from on or about 1964 to and including March 1973, Equity Funding and its management conspired to commit and did commit numerous fraudulent acts and practices, including but not limited to the creation and inflation of assets and earnings reflected in Equity Funding's financial statements; the creation of bogus insurance policies which were co-insured with other insurance companies; and the creation and maintenance of false and fraudulent business records. The effect of these acts and practices was to inflate Equity Funding's earnings and assets and to create a false and misleading appearance of sustained growth by Equity Funding as reflected in various periodic reports filed by the company with the Commission, and in reports to its shareholders.

Q. On November 1, 1973 a Federal Grand Jury in Los Angeles, California returned a 105-count indictment in connection with the Equity Funding matter against 22 persons, including certain of Equity Funding's officers and directors, for conspiracy to commit certain federal violations, including violations of the antifraud provisions of the federal securities

laws, filing fraudulent registration statements under the Securities Act of 1933, filing fraudulent reports under the Securities Exchange Act of 1934, mail fraud, bank fraud, interstate transportation of counterfeit securities, interstate transportation of securities taken by fraud and electronic eavesdropping. The defendants were charged with various substantive counts for offenses which were the object of the conspiracy. These proceedings have been concluded by the entry of guilty pleas or the conviction after trial of all defendants for one or more of the counts against them.

R. From on or about March 6, 1973 to and including March 27, 1973, respondents Dirks, III, Bristol Co., Dreyfus, Manning & Napier and TZP, directly and indirectly, wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; that in connection with the purchase and sale of Equity Funding securities, they, directly and indirectly, employed devices, schemes, and artifices to defraud, obtained money and property by means of untrue statements of material facts, and omissions to state material facts necessary in order to make the statements made in the light of the circumstances in which they were made, not misleading, and engaged in transactions, acts and practices and a course of business which would and did operate as a fraud and deceit upon the purchasers and prospective purchasers of such securities; in that:

1. From on or about March 6, 1973, to and including March 27, 1973, Dirks acquired material nonpublic information concerning the affairs and business of Equity Funding, including, but not limited to, information

(a) that Equity Funding had issued and was carrying on its books and records fictitious life insurance policies and supporting records relating to such policies;

(b) that Equity Funding had been carrying on its books and records fictitious assets and earnings;

(c) that Equity Funding had publicly issued false and fraudulent statements of insurance premium income;

(d) that Equity Funding had publicly issued false and fraudulent financial statements; and

(e) that officers and employees of Equity Funding had engaged in the fraudulent schemes and courses of conduct as set forth in subparagraphs (a) through (d) above.

2. From on or about March 12, 1973, to and including March 27, 1973, while respondents III, Bristol Co., Dreyfus, Manning & Napier and TZP ("selling respondents") were in possession of material, non public information conveyed to them by respondent Dirks, which information is set forth in paragraph 1 above, such selling respondents sold or caused to be sold Equity Funding securities for their accounts or from the accounts of others without disclosing such information to the purchasers of the Equity Funding securities sold or caused to be sold by the selling respondents.

3. From on or about March 12, 1973, to and including March 21, 1973, Dirks conveyed the information set forth in paragraph 1 above to III.

4. On March 15, 1973, III sold for its clients 36,500 Equity Funding common shares for net proceeds of about $942,795. On March 16, III sold for its clients $300,000 face value of the debentures for net proceeds of about $260,133. On or about March 21, 1973, III sold on behalf of clients 371,500 Equity Funding common shares and $575,000 face value of the debentures for net proceeds of about $7,117,157 and about $436,[illegible], respectively.

5. On or about March 26, 1973, Dirks conveyed the information set forth in paragraph 1 above to TZP, which on March 26, 1973 sold for clients approximately 24,920 Equity Funding common shares for proceeds of approximately $428,028, and $60,000 face value of the debentures for net proceeds of about $43,382.

6. From on or about March 23, to and including March 26, 1973, Dirks conveyed the information set forth in paragraph 1

above to Dreyfus, which, on March 26, 1973, sold for its own account $500,000 face value of the debentures for net proceeds of approximately $362,993.

7. On or about March 26, 1973 Dirks conveyed the information set forth in paragraph 1 above to Bristol Co., which immediately thereafter sold for its clients approximately 457,200 Equity Funding common shares for net proceeds of approximately $7,929,134, and $200,000 face value of the debentures for net proceeds of approximately $152,697; and the Bristol Employees Plan sold 600 Equity Funding common shares for net proceeds of approximately $10,399.

8. On March 26, 1973 Dirks conveyed the information in paragraph 1 above to Manning & Napier, which on March 26, 1973 sold about 5,450 Equity Funding common shares for its clients for net proceeds of approximately $89,922.

9. From on or about March 15, 1973 to on or about March 27, 1973 Dirks conveyed the information in paragraph 1 above to other large shareholders of Equity Funding securities, which shareholders are not registered with the Commission. From on or about March 15, 1973 to on or about March 27, 1973 these shareholders sold Equity Funding securities for proceeds of approximately $8,900,000.

S. As a result of the activities described above, the respondents violated and aided and abetted violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder.

T. While engaged in the acts and practices described above, Dirks and the selling respondents, directly and indirectly, used or caused to be used the mails and means and instruments, and instrumentalities of transportation and communication in interstate commerce and the facilities of a national securities exchange.

III

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest and for the protection of investors, that public proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and in connection therewith to afford the respondents an opportunity to establish any defenses to such allegations.

B. What, if any, remedial action is appropriate in the public interest, pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934, Sections 203(e) of the Investment Advisers Act of 1940 and 9(b) of the Investment Company Act of 1940.

IV

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof be held at a time and place to be set, and before an Administrative Law Judge to be designated by further order of the Commission, as provided by Rule 6 of the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the respondents file an answer to the allegations contained in this order for proceedings within 15 days after service upon them of said order, as provided by Rule 7 of the Commission's Rules of Practice.

If any party fails to file the directed answer, or fails to appear at a hearing after being duly notified, such party shall be deemed in default and the proceedings may be determined against such party upon consideration of this order for proceedings, the allegations of which may be deemed to be true.

This order shall be served upon the respondents personally or by certified mail forthwith.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of in-

vestigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision upon this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 4(c) of the Administrative Procedure Act, it is not deemed subject to the provisions of that Section, delaying the effective date of any final Commission action.

By the Commission.

George A. Fitzsimmons
Secretary

/s/ SHIRLEY E. HOLLIS
By: Shirley E. Hollis
Assistant Secretary

ADMINISTRATIVE PROCEEDING
FILE NO. 3-5068

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

September 10, 1976

In the Matter of

BOSTON COMPANY INSTITUTIONAL INVESTORS, INC.
(801-6829)

JOHN W. BRISTOL & CO., INC.
(801-4726)

RAYMOND L. DIRKS

THE DREYFUS CORPORATION
(801-8147)

MANNING & NAPIER
(801-6611)

TOMLIN, ZIMMERMAN & PARMELEE, INC.
(801-8853)

ORDER AMENDING ORDER FOR PUBLIC PROCEEDINGS PURSUANT TO SECTION 15(b) AND 19(h) OF THE SECURITIES EXCHANGE ACT OF 1934, SECTION 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940

I.

The Commission, having by order dated August 24, 1976, instituted public proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934, Section 203(e) of the Invest-

ment Advisers Act of 1940 and Section 9(b) of the Investment Company Act of 1940 in the matter of Boston Company Institutional Investors, Inc., *et al.*, and the Commission having duly considered the matter and having determined it to be in the public interest,

HEREBY ORDERS pursuant to Rule 6 of the Commission's Rules of Practice that said Order for Public Proceedings be amended as follows:

Paragraph C of Section I shall be amended and shall read as follows:

> C. The Dreyfus Corporation ("Dreyfus") has at all times since December 10, 1971 been registered with the Commission as an investment adviser. Its principal place of business is 767 Fifth Avenue, New York, New York 10022. Since on or about July, 1972 Dreyfus has been the investment adviser and manager of the portfolio of the Dreyfus Special Income Fund, Inc.

Paragraph R, subparagraph 2 of Section II shall be amended and shall read as follows:

2. From on or about March 12, 1973, to and including March 27, 1973, while respondents III, Bristol Co., Dreyfus, Manning & Napier and TZP ("selling respondents") were in possession of material, nonpublic information conveyed to them by respondent Dirks, which information is set forth in paragraph 1 above, such selling respondents sold or caused to be sold Equity Funding securities from the accounts of others without disclosing such information to the purchasers of the Equity Funding securities sold or caused to be sold by the selling respondents.

Paragraph R, subparagraph 6 of Section II shall be amended and shall read as follows:

> 6. From on or about March 23, to and including March 26, 1973, Dirks conveyed the information set forth in paragraph 1 above to Dreyfus, which, on March 26, 1973, directed the sale for the Dreyfus Special Income Fund, Inc. of $500,000 face value of the debentures for net proceeds of approximately $362,993.

II.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III of the Order for Public Proceedings dated August 24, 1976, as amended, be held at a time and place to be set, and before an Administrative Law Judge to be designated by further order of the Commission, as provided by Rule 6 of the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the respondent, The Dreyfus Corporation, file an answer to the allegations contained in the aforementioned Order for Public Proceedings as amended within 15 days after service upon it of said order, as provided by Rule 7 of the Commission's Rules of Practice.

If said party fails to file the directed answer, or fails to appear at a hearing after being duly notified, such party shall be deemed in default and the proceedings may be determine against such party upon consideration of this order fo proceedings, the allegations of which may be deemed to be true.

This amending order shall be served upon the respondents personally or by certified mail forthwith. The Order for Public Proceedings dated August 24, 1976, and this amending Order shall be served upon The Dreyfus Corporation personally or by certified mail.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision upon this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 4(c) of the Administrative Procedure Act, it is not deemed subject to the provisions of that Section, delaying the effective date of any final Commission action.

By the Commission.

/s/ GEORGE A. FITZSIMMONS
George A. Fitzsimmons
Secretary

EXCERPTS OF TESTIMONY OF RONALD SECRIST

[R. 242] Q Was there any discussion in the course of [R. 243] your conversation concerning how you had come to Mr. Dirks with this story?

Q Did he ask me that?

Q Or did you volunteer it?

A No, not that I recall other than I told him that we had a mutual friend in Pat Hopper. I may have implied that Pat suggested him.

Q Did he ask you whether you had any personal motivation in bringing this story to him?

A He most certainly did.

Q What did he ask you and what did you say to him at the time?

A Well, at the end of my story he leaned back—he'd been writing furiously. He had written out many pages in a three-hole notebook, 8½x11 size. I would—I don't know if it means anything—I would estimate he wrote eight or ten or twelve pages.

Mostly that's what he was doing, in answer to a previous question, he didn't ask very many questions; he just sat there writing all of the time.

At the end of our convesation or nearing the end of our conversation, he leaned back and looked me very squarely in the eye and said, "Why are you telling me all of this?"

Q And what did you say?

[R.244] A Do you want me to continue on with my answer?

Q Yes, please.

A And I said, "Because I want you to take this information and do something with it. I expect you, first of all, to verify it, not just take my word for it."

I gave him names of people he could verify it with.

I told him that I expected him to verify it and get the information out to stockholders or to the investing public. I

told him that I wanted to make it known generally, and that I felt that, if this information were widely enough circulated, that it would bring the result that I wanted.

He next asked me what did I want from all of this. I think more specifically: "What do you want from me?"

I repeated that I wanted him to give out the information.

And he asked me if I was expecting some payment from him.

I said, "Most certainly not." I told him that I had received an offer, a very circuitous offer, from someone who wanted me to make this information available so they could short the stock and then cause the stock to drop by revealing the information, and that I had refused [R.245] to talk to them.

Then he asked me if I had any interest in the stock.

I told him no. I very specifically said that I did not own any shares, that I was not short any shares, that I had never owned any shares, I had never exercised any of my openings, and on and on.

* * *

[R.331] Q Mr. Secrist, when you finally decided to share your information with the New York State Insurance Commissioner and with Ray Dirks, could you tell us, did you have a strategy in mind?

A Well, I put together an outline of what I was going to talk about, as I mentioned earlier.

[R.332] Q Did you ask Mr. Dirks to do anything with the information that you gave him?

A Yes.

Q What did you ask him to do with that information?

A I asked him to disseminate—well, I asked him, first of all, to check it out and verify its accuracy and authenticity and then to disseminate it as wisely and as quickly as possible.

Q Why was it important that the information be disseminated quickly, in your mind?

A Well, this comes back to my opinion of the SEC.

Q Go ahead.

A I felt that—

(Laughter)

A I felt that the regulators—well, I was of the opinion that the regulators had not acted in the past; which was off, on information that they had received.

I knew that other people had gone, at various times—and I had no idea how many more people may have gone, but this was talked of widely in the company.

I knew that every time somebody went to [R.333] a regulator with information and was brushed aside with a comment that that's a ridiculous story, that made it tougher for the next person to do.

And it was just a disgruntled employee or crazy employee action—in quotes—from the regulators.

I was of the opinion that it was necessary to put on as much heat as possible and as fast as possible.

I felt that the only way to resolve the problem was to bring the anger of the public opinion to bear in great force and effect on the regulators.

That would finally force them to move.

Q How was Mr. Dirks going to figure in this?

A Mr. Dirks was going to go to the heart of the matter, which was the stock price, which was the all-pervading interest in the corporation.

And by jarring the stock, he would jar the corporate—this was my plan—he would jar the corporate officers and would also rattle the Wall Street financial community to the extent that someone would take action very quickly.

* * *

[R.347] Q With respect to the same area that we have been going into as to your testimony yesterday, I believe you mentioned that you had some conversations with Mr. Blundell.

Do you recall that?

A Yes.

Q You did have some conversations with Mr. Blundell?
[R.348] A Yes, I did.

Q Do you know who Mr. Blundell is?
A Yes.

Q Who is he?
A He was bureau chief of the Wall Street Journal, Los Angeles.

Q And did Mr. Blundell call you or come to see you?
A He called me.

Q And where were you then, at the time?
A I was in Atlanta, Georgia.

Q And do you recall the gist of your conversation with Mr. Blundell?
A It was a very long conversation.
He called me at my—I believe the first time he called me that I was at my motel room in the evening.
It was rather late at night actually in Atlanta, like maybe ten—well, not real late, may ten o'clock or so.
As I recall, we talked for at least an hour, perhaps two hours.
The gist of the conversation, I guess I could fairly say I told him everything that I had told Ray Dirks.
[R.349] He was trying to put together a story.
I gave him as much information as I possibly could.

Q Did he tell you—
A I tried to back him up.
I tried to give him all of the detail, the authenticating information, the verification.
I was trying to help him write his story.

Q Did he tell you that he was going to write a story or that he was trying to write a story?
A I don't recall him specifically saying that, but I knew at the time that that was what he was doing.
I'm quite sure that he did tell me that in some form or other.

Q Do you recall the date of your conversation with Mr. Blundell?

A I don't recall it.

It's on the record.

I read it from my notes yesterday.

Q All right.

And—

A It was approximately two weeks after I went to the New York Department, within a few days.

Q Did you encourage Mr. Blundell to write [R.350] a story?

A Definitely.

Q Did you think that having an article in the—on your information in the Wall Street Journal was consistent with your plan?

A Most definitely.

Q Do you recall in the course of your conversation—I believe you testified yesterday that Mr. Blundell asked you whether you had any hard evidence in support of your allegations?

A Yes, he asked me that.

Q And what did you tell him about hard evidence then?

A I believe I told him what I had in my pocket at the time I talked to the New York State Department and Ray, which was those two little pieces of paper which have been entered into evidence here, or more.

And that we spent some time, perhaps a half hour, discussing this question at this point and in other conversations with him.

And basically, I told him that it just didn't exist.

I told him that in, oh, a dozen different ways.

[R.351] The only way he could obtain the information would be to get into the company and steal it and that it would be very difficult to do that.

Q You had, I take it, an understanding at the time of what Mr. Blundell was using the term "hard evidence" to mean?

A Well, he made it very specific.

There was no question about what he was asking about.

Q And what was he asking?

A He wanted proof, he wanted documentation, he wanted pieces of paper that would prove the story so that he wouldn't be involved in possible libel.

Q And the only documentation that you had were the two confirm slips which have been introduced this morning as Exhibits 3 and 4 for the division?

A Yes.

I would say that was the only documentation that I had which would be of any significance to what he was trying to accomplish.

You know, I had things like convention statements, annual statements and normal company financial material things.

* * *

[R.359] Q Why did you go to see Mr. Dirks?

A We had mutual acquaintances.

I had known of Mr. Dirks for a period of over two years.

I had never met him or talked with him, though.

I had read an article about him in the Wall Street Journal.

Our mutual acquaintances were of the opinion that Dirks was a very ethitical [*sic*] man who would use this informatioon in what I considered the proper manner.

[R.360] Basically, I thought that he was the man who could do the job.

Q And—

A He was well known as a life insurance analyst, which I should put in also—an insurance analyst—which is significant, of course, so he could understand what I was talking about.

Q And by using it in the proper manner, you meant disseminating it widely?

A Yes.

Q Did you tell Mr. Dirks when you met with him that you'd been fired by the Equity Funding Group?

A No, I did not.

Q What did you tell him?

A I told him that—I believe that I told him that I had resigned.

He asked me that question.

I tried to sidestep it.

Finally he pinned me down, and I had to come up with some sort of a statement.

I felt that I wasn't lying on that point because the officer can't be fired except by the Board of Directors, because that's who appoints him.

So, technically, an officer has to resign.

Q Well, why didn't you tell him—

[R. 36l] A I was asked, but I still—

Q Excuse me.

Why didn't you tell him pointblank that you had been fired?

A I felt that would cloud the issue.

I felt it was immaterial to what I was trying to accomplish.

I was going to do this regardless of whether I was fired or quit or whatever.

Q You mean when you say, "cloud the issue," you mean affect your credibility?

A I was afraid it would make me look like a disgruntled employee trying to get even with somebody, which was not the case.

Q And for that reason, you told Mr. Dirks when you couldn't sidestep it, you told him that you had resigned?

A Yes.

Q Were you concerned about your credibility when you went to see Mr. Dirks?

A Most definitely.

Q Why were you concerned about your credibility?

A As I have said before, I felt that I had one bullet to shoot.

If I missed, it was all over.

I felt that I had to make the most credible [R. 362] statement possible, that I had to present myself as a reliable, responsible member of the business community and that I had to convince him thoroughly that what I was saying was correct and true and convince him enough that he would act on the information.

Q And didn't you think that the story you were telling was kind of believable on its face?

A No, I did not.

Q I see.

A No rational man in the life insurance industry would say this is possible to do.

Q So you thought you were laboring from that position of disadvantage to start with, you didn't want to add to it by telling him that you had been fired?

A I was at a gross disadvantage.

* * *

[R. 369] Q When you talked to Mr. Dirks over lunch on the 7th of March, did you talk about the Wall Street Journal at all?

A Yes.

Q And how did that arise?

A Well, a couple of things.

I mentioned the article about him for one thing, [R. 370] you know, as part of the reason that I had come to him.

And another thing, he mentioned Herb Lawson, Bureau Chief of the San Francisco Bureau, and asked my permission to give this information to Herb Lawson.

Q Which information?
A The information that I was giving Ray.

Q So Dirks told you that he was going to take this information to the Wall Street Journal?
A He asked my permission to do so.

Q Did you give it?
A Yes.
I believe he may have made a statement further than that.
I don't recall precisely at this time.

Q Did you have occasion in that meeting in in [*sic*] any of your conversations with Mr. Dirks, to tell him that you knew that people had taken the information that you had or similar information to the Securities and Exchange Commission?

* * *

[R. 371] A Yes.

Q When did you tell Mr. Dirks that?
A Well, we discussed it in nearly every one of our phone conversations after the original meeting.
At the original meeting, I don't recall whether we discussed it or not.

Q And when you say you discussed it, do you recall what was said about persons who had previously gone to the SEC?
A Well, we discussed the fact that they got no results and that they were placed in personal jeopardy as a result of having gone there.

[R. 372] Q And when you say placed in personal jeopardy, what do you mean by that?
A There [*sic*] lives were threatened in the corporation; their positions, their careers and their jobs were threatened or they were fired or whatever.

* * *

[R. 453] Q Now, I believe it was on March 7, 1973 that you talked first to the New York State Insurance officials and then later that day to Mr. Dirks.

Is that correct?

Is that the date?

A Yes.

Q How much time did you spend with the New York State Insurance officials?

A Approximately three hours.

Q Did the ground covered in your conversations with the New York State Insurance officials differ or was it the same as that—or substantially the same as that covered in your later subsequent [*sic*] conversation with Mr. Dirks?

A It was virtually the same.

Q Did you tell the New York State officials [R. 454] that you were going to see Mr. Dirks?

A I did not.

Q Did you tell them that you had—

A I did not at the time I talked to him the first time, on March 7.

Q Yes.

That's when I'm referring to.

Had you by then had your conversation with the Wall Street Journal reporter who was in Los Angeles?

A No, I had not.

Q That occurred subsequently?

A Yes.

Q I see.

On March 7, 1973, Mr. Secrist, was it your then intention [*sic*] to talk only to the New York State officials and to Mr. Dirks?

Or did you have in mind possibly talking to other people too?

You have testified at another point that you considered the possibility of talking to various other people, including certain

U.S. senators and Jack Anderson, who is a columnist, and other people.

Did those possibilities exist in your mind at the time that you talked to the New York State Insurance officials?

[R. 455] A No.

I was set on talking to those two entities, and that was all.

Q As of March 7, 1973?

A Right.

Q But this list you drew up, had you drawn that list of possible persons to talk to prior to March 7?

A Many months prior.

It was a dynamic list.

I was adding and subtracting over a period of many months.

Q Yes.

But by March 7 had you—you had more or less settled on talking to these two particular—

A I had firmly settled on those two, yes, your Honor.

Q Just to recapitulate:

You didn't tell the New York State Insurance officials that you were going to talk to Dirks?

THE WITNESS: That's correct.

Q And you didn't tell Dirks that you had earlier talked to the New York State Insurance officials?

A Not on March 7th, no.

[R. 456] Q And again, your reason for that was what?

A The reason I did not tell Dirks is because the New York State Insurance officials told me not to tell anyone that I had been there or not to discuss it in general.

The reason I didn't tell the New York State Insurance Department because [*sic*] I suspected they might not be too happy about me talking to someone else.

I had already made up my mind that I was going to do it.

They asked me if I had talked to someone else, which I could answer honestly, no.

They didn't ask me if I was about to.

Q Why did you feel it necessary to explore both of these avenues or try to utilize both of these avenues for making sure that the disclosure was made?

A Because I didn't have total confidence in any regulatory body that they could achieve the goal that was necessary in revealing what was going on at the company.

I felt that I had to have additional leverage and just like presenting a court case, I wanted to present my best case the first time.

* * *

[R. 458] Q And what did you expect Mr. Dirks to do with this information?

How did you contemplate that his knowing this information would result in its becoming broadly known to the investment community or to the public at [R. 459] large?

A Well, I understood him to be very active in analyzing insurance securities.

Therefore, he would be—therefore, he and his firm, your Honor, would be well known to investers [*sic*] in insurance securities.

I expected him to disseminate this information to his firm's customers, clients.

Q You didn't expect him to be—to put a notice in the Wall Street Journal, did you?

A Hardly.

Q Or write an article in one of the business publications?

A No.

I perhaps naively thought that—I didn't know what technique he might use, but I thought perhaps he might send it out in some kind of a bulletin to his clients.

I didn't really—I had not thougth [*sic*] through that thing.

I figured that that was his province, not mine.

Q Did you discuss with him at all what follow-up he would make or what he would do with the information that you were conveying to him—

[R. 460] A Yes.

Q other [*sic*] than the first checking—other than first checking it out?

A Yes.

As you say, I told him that I expected him to check it out.

I felt that added to my credibility.

I certainly would not expect a man of his calibre to go out and take a comment from one individual and start spreading stories as wild as the one that I was telling him, or apparently wild.

And, yes, we discussed at some length, your Honor, perhaps for 20 minutes or so, what I had expected him to do with the information.

Q What was that conversation?

What did you say to him and what did he say to you?

A Well, when I concluded my speech, if you will, my formal presentation, I stopped talking and waited for him to ask me a question, or whatever he was going to do.

And when he finished writing what he was writing, his notes, he leaned back and said, why are you telling me this.

And I sayd [*sic*], I want you to check this [R. 461] information out and satisfy yourself as to its authenticity and then disseminate it to the investment community.

And we discussed that at some length as to how he's [*sic*] going to disseminate it and how he would check it out and things of that nature.

Q With respect to checking out, did you discuss at all if he found the information to be verified by other sources—did you discuss what he would do with it, what the mechanics would be?

A No, no.

We didn't discuss mechanics.

I just told him that I wanted him to get the information out as broadly as possible.

My goal was not publishing a newspaper.

My goal was getting the situation that was going on at the company stopped.

This was a means to an end.

This was not an end, the publishing of the information.

Q I think you testified earlier at one juncture that your purpose was to jar the Equity Funding stock.

And by that I take it to mean you meant that you hoped that through Mr. Dirks, the stock of Equity Funding would drop precipiously [*sic*].

I think you said to zero.

[R. 462] A I said that in my testimony, yes.

I expected it to drop close to zero very quickly, yes.

Q And that was your purpose in talking to Mr. Dirks?

A That was not my purpose, that was one of the steps in achieving my purpose.

Q And what was your long-range, overall purpose?

A My purpose, your Honor, was to reveal the fraud to the world.

Q All right.

A And to prevent its continuation.

* * *

Q Mr. Secrist, I believe you just stated, in response to one of Judge Markun's questions that you did not contemplate that Mr. Dirks would get this all published in the Wall Street Journal.

[R. 463] Is that what you said?

A I think the way he said it was—I interpreted or I understood the way he said it is that his firm would take an ad in the paper or something like that.

That wouldn't seem reasonable to me.

Q I do just want to make it perfectly clear that your testimony was that you and Mr. Dirks did discuss in that meeting the possibility of his going to the Wall Street Journal with the story.

A We discussed going to the Journal and having a reporter do the work, but not Mr. Dirks himself putting the story in the journal [*sic*].

Q All right.

But you were perfectly aware, then, weren't you, that Mr. Dirks might well take this story to the Wall Street Journal and use that to disseminate it?

A I expected that he would.

Q Thank you.

* * *

EXCERPTS OF TESTIMONY OF RAYMOND DIRKS

[R. 476] Q Did there come a time in March of 1973 when you were contacted by Ronald Secrist?

A Yes.

Q All right.

Do you remember when that was?

A March 6, 1973.

Q And do you remember the nature of the contact?

A A telephone call.

* * *

[R. 477] Q What did Mr. Secrist tell you?

A Well, to the best of my recollection he said he thought—he introduced himself and said he was a friend of Patrick Hopper and that he had once worked for Equity Funding Corporation and Bankers National Life and that he had some information he thought I would be interested in hearing about.

He sort of rambled on about Y business, about one-third of thdir [*sic*] business he alleged was fictitious life insurance business.

I believe he was referring to Equity Funding Life Insurance Company.

I think he said something about fake certificates of deposit and other sorts of activities that would indicate the company was doing some mighty unusual things.

And he said he wanted to—I don't remember all of the details from memory.

He said he wondered whether I would be interested in hearing.

Well, I don't think he—I think I said, well, if you have something, why don't you come in and see me.

He said that he would like to come in.

I said that if you want to come in—when [R. 478] would you like to come in.

He said, tomorrow.

I said, about what time.

He said, around midday.

I said, I have a one o'clock appointment.

He said, it would make it kind of difficult for me to try to get up a little before one or before, I think twelve.

I said, would you like to have lunch.

He said he didn't know whether he would have time to have lunch but that he would try to be there before I had to go to my one o'clock appointment.

Q And in fact did Mr. Secrist keep his appointment with you for the day following?

A Yes.

Q Can you tell us what took place?

A Well, as I recall it, I was—he didn't get there until about 12:30.

I told Allen Gorrelick, who was the life insurance specialist, more or less, that since this individual had called, that it sounded like a very strange and crazy story—I described it briefly to Allen—and I said maybe you will have to go along on this.

He said he didn't think it was of any interest.

[R. 479] Well, I said I might have to go to lunch, so when he comes in—or, I might have to go to an appointment—that when he comes in, would you take care of it if I'm not here.

He said he would.

But about 12:30, Secrist was announced.

I went out to greet him.

I brought him into my office.

I said to Allen, come on, let's go to lunch. Secrist said he would go out to lunch.

So we went out to P.J. Moriarty's.

Q And how long did you stay with Mr. Secrist?

A I think about three and a half hours.

Q Can you tell us what he told you?

A Well, in essence, he started off by saying that he was at Bankers Lifre Insurance [*sic*] Company where he had been for over a year.

He said that he was—but that he had left there—I'm sorry, when I say was, he had been there, he left there. He was no longer employed, that he had resigned.

He said there were a lot of—that a number of other officers of Bankers National were dissatisfied and some of them were leaving or had left recently, including the actuary and the chief accountant.

[R. 480] He said that at Bankers National, the company was—the reasons a lot of these people were leaving was that they were dissatisfied with the way the management of Equity Funding was allocating expenses.

They were not happy with the way the company was being managed.

He indicated that it was a very sloppy organization.

He indicated also that he had been led to believe a few months earlier that he was going to be made the chief operating officer at Equity Funding, that this had not come to pass—I mean, of Bankers National—I'm sorry—and that this had not come to pass.

He went into great detail about that company.

He also indicated that he had some allegations to make about Equity Funding, namely, that he claimed that someting [*sic*] in the area of one-third of their life insurance in force was fake and that they called this the Y business.

This resulted, he thought, in fictitious assets.

He wasn't sure how this occurred exactly.

He indicated that he had worked at Equity [R. 481] Funding up until about a year and a half ago, prior to that, rather, and that he was—and that there had been a lot of common talk around the company about this fictitious insurance in force.

He said that people had told him that the company was not only creating fictitious insurance in force, but they were making up fake—but that they were selling this insurance to other insurers through the device known as co-insurance.

He said that the company was—that officials of the company or someone at the company was making up fictitious death certificates to collect the proceeds of these fictitious insurance policies from other life insurance companies.

He thought that—he said that from what he heard there was fictitious certificates of deposits made up to create fictitious assets.

He said that the company used some sort of outside printers to accomplish this.

He alleged that most of the top officers of Equity Funding were probably involved in this alleged creation of fictitious insurance.

He named quite a few individuals that he thought were involved.

He named some others that he thought were not [R. 482] involved.

He said he didn't know much, if anything, about the parent company, Equity Funding Corporation of America.

He said there was no real fraud at Bankers National, that that had been given some—or, asked to reinsure some fictitious insurance that—well, actually he wasn't sure whether it was fictitious, but the Pennsylvania Life had been given some of this—he thought had been given some of this Y business and that Pennsylvania Life had told Equity Funding that they didn't—that they didn't like that business and they wanted Equity Funding to take it back.

So Equity Funding was attempting to force Bankers National to accept this fictitious business.

Obviously it was a three and a half hour conversation, so he went through a lot of additional material which I'd be happy to try to recall.

I don't know what you are—what you want me to do here.

Q Well, did you take notes at that meeting?
A Yes.

Q Do you have a copy of those notes with you?
A Yes, I do.

[R. 483] Q Perhaps—have you exhausted your recollection of what took place there?

A I don't think so.

Q Why don't you keep going and then when you get to the end of your present recollection, then refer to your notes, fill in the gaps.

A Well, naturally he told me about his history in the insurance and how he had come to arrive at Equity Funding.

We discussed Pat Hopper and we both had some acquaintance with him, although I had only met once in my life and only had talked to him two or three times.

We talked something I think about Pacific Standard Life.

We discussed what he—what his administrative role was at Equity Funding.

I don't believe he said he was an officer of Equity Funding Life, but he did say he was an officer of Bankers National.

We discussed his perception of some of thes [*sic*] individuals that he had said were responsible primarily for this allegedly fictitious insurance.

He indicated that Fred Lavin [*sic*] was sort of the mastermind of the whole affair as far as he knew.

He said that he didn't know, to his knowledge, [R. 484] about some of the others.

He indicated Art Lewis was sort of the evil genious [*sic*], I think he called him.

He mentioned Eden and—let's see—I think Sultan and Collins and Simons and Banks and all these people who were not listed in the annual report of the company as I later discovered.

They were, he claimed, knowledgeable about this particular fictitious insurance.

Let's see.

He indicated—well, naturally, of course, I asked him what the purpose of this whole—well, I think I asked him why he was—why he thought these guys were doing what they were doing.

He said they were—he said none of them were—none of them had managerial experience, they were all technicians.

He listed their, more or less, professional backgrounds.

He indicated they were mostly accountants or actuaries or lawyers but they had no—they were very bright people, high IQ's, 140 or 150 or more, but that they had very little in the way of administrative experience.

Therefore, the whole place out at Equity [R. 485] Funding Life, as far as he knew it, was in pretty much dissaray [*sic*].

He said that it was common knowledge, all this, what he was telling me, had indicated that it was common knowledge around the water cooler where everybody talked about it.

He said it was treated as sort of a joke. People in charge, these individuals he had named, he said they were bery [*sic*] young executives, way over their heads, even though they were smart.

Then he said they really didn't realize, he didn't think, what they were doing.

He didn't even know whether they realized that it constituted a fraud.

Of course, I asked him whether he had any sort of documents or whether he had any materials that he had brought him to substantiate some of this that he was telling me.

He said he really did not.

He sort of sheepishly pulled out a couple of pieces of paper and said, well, this is about the only thing that I got.

He showed me two confirm slips which he said represented funded programs accounts that had been sent to him.

[R. 486] Q I show you Exhibits 3 and 4.

Are those copies of what Mr. Secrist showed you?

Of course they would have been folded at the time.

A Yes.

They don't look exactly the same.

I thought it was just one piece of paper.

It could very well be that he showed me this.

MR. MEISTER: I object and move to strike as to what could be.

I ask the witness to state whether he remembers or doesn't remember.

JUDGE MARKUN: I will ask you to give your best recollection as to whether you have seen these documents before.

THE WITNESS: Well, your Honor, I definitely remember seeing the names Christ and Secret.

I presume this is it.

My best recollection would be that it would be these documents.

JUDGE MARKUN: All right.

THE WITNESS: But I don't believe—for one thing, your Honor, he didn't give them to me to keep.

[R. 487] They didn't seem to have very much significance.

In any event, he said that he really didn't have any other evidence.

He didn't indicate that he himself—

Q Any documentary evidence, Mr. Dirks?

A Well, right, that's correct.

Q Do you remember anything else that was said?

A Well, naturally I asked him if he, himself, had been engaging in any of these activities or was directly knowledgeable about it.

He indicated to me that he had not and really had no direct knowledge of the accounting, how the books were affected.

In fact, he—it was pretty much speculation as to how this whole thing showed upon the asset side of the balance sheet or on the income statement.

* * *

[R. 488] He indicated that—well, of course, we asked about—when I say we, I'm talking about both Allen Gorrelick and myself.

Allen Gorrelick was present at the meeting, as I indicated earlier.

We pressed him on how this could have—on how this sort of alleged fraud could have occurred in the face of the substantial amount of regulation that the company had in terms of both from the insurance departments of the various states and from the SEC and, of course, the auditing firms.

I asked him who the auditors were.

I don't think he was completely sure of who the auditors were at Equity Funding Life, at the present time at least. That was 1973.

The auditors—he said he was more aware about, I think—most aware about, as I recall, were the [R. 489] ones for Ranger National.

He mentioned Peat, Marwick, Mitchell coming in and how they seemed to have come very close several times to discovering this alleged fake insurance, but how the various officials at the company had intimidated the auditors by throwing them out of the office or—particularly some of the young auditors that came in.

He indicated that he thought the company had—that the company officials had occasionally made up fake insurance policies in order to show the auditors but that this wasn't necessary for every policy, that it would be impossible to do that, or the number of policies that he was claiming fraudulent.

Of course indicated that other people—you know, it was generally common knowledge within the company about the fraud, about the alleged fraud, and that some of the people in the company were caught up in it, they saw it as a way to get status in the community.

He said many of these officials that were involved didn't really make a lot of extra money by getting involved but they were—but they wanted status, they wanted to get promotions, they wanted to become well liked and known among their peers and so forth.

[R. 490] He said others within the company were not at all happy with what was going on.

He said that some people—quite a few, had left the company.

He indicated that some of them had tried to go to the regulatory authorities without success.

He said he thought it would be very difficult to have this thing exposed or brought to the—to a halt by going to regulatory authorities.

He talked about the insurance departments, the SEC, the accounting firms.

Of course he said he didn't trust the Illinois Insurance Department.

He indicated Fred Levin had worked there as an attorney.

He said he was told that the Illinois Insurance examiners had been paid off, by Equity Funding.

Naturally I asked him why he came to me.

He said he came to me because Pat Hopper had recommended me.

He thought perhaps I could check out some of these—some of what he said and see if I could do something about it.

He indicated—I think we spent quite a [R. 491] bit of time on the sales force.

He indicated he felt an analyst by looking at the annual reports and looking back over the history of the company and knowing what the number of salesmen were, which was generally public information, and looking at the amount of sales the company reported, could become somewhat suspicious about whether or not the company was reporting true sales figures.

I think we discussed the other insurance departments at some—whether they had any knowledge of this.

I think he indicated that other approaches had been made to the various insurance departments.

He indicated some people had gone to the SEC without success.

I told him that I thought that if he expected me to do anything about this, that I wouldn't feel comfortable unless I could talk to somebody that I felt would have the type of experience and ability to expose this fraud.

I mentioned the Wall Street Journal.

I specifically mentioned that I knew a fellow named Herb Lawson who was an investigative reporter with the Wall Street Journal.

I told him tht Herb Lawson had good [R. 492] contacts with regulators, and that, through somebody like Herb Lawson, that I thought that, if I could get him interested in this, that we

might have some success if this fraud existed after I checked it out, that we might have some success in getting done what Secrist seemed to want done.

I specifically asked his permission if I could contact Herb Lawson.

He said—He thought for a minute. Then he said, "Yes, if you think so, if you think that's best," or something to that effect.

* * *

[R.493] He made it clear that he didn't want his name bruited about. That's of course why he had done that before I brought up Herb Lawson, and that's why I specifically got his permission to talk to Herb Lawson.

I assured him that I thought a reporter with a respected publication like The Wall Street Journal would not divulge his source.

* * *

[R. 614] Q And were you asked this question:

Did you do anything about the information that Mr. Secrist gave you between the 7th and the 19th?

And did you give this answer:

Yes. I did some analysis and research on the company. I took my file, which was fairly extensive, and analyzed the company.

I checked my records to see if any of my clients owned the stock and I found that only—well, first of all, I recalled immediately before I checked my records that one institutional analyst had come in to see me bout [*sic*] two months before about it and his name is Jerry Zukowski. He works for Boston Company Institutional Investers [*sic*].

Did you give that answer?

MR. DEITZ: And, gentlemen, if you want to add to it because I've not read the entire answer, just the first two paragraphs, I'll have no objection.

BY MR. DEITZ:

[R. 615] Q Did you give that answer?

A Well, that was the—that's what I said there.

Q And was it true?

A Well, it is obviously not completely clear.

The way I—I did not check my records to see whether any clients owned the stock.

I recalled, as I testified earlier, that one—that one individual expressed an interest to me in Equity Funding.

I did not know whether—who owned the stock.

I never did learn whether anybody that I talked to—had talked to owned the stock.

* * *

[R. 789] Q Well, weren't you impressed enough with what Mr. Hopper had told you that you asked him if he would talk with your friends at the Boston Company Institutional Invester, Inc. [*sic*] on the telephone?

* * *

A Well, I was impressed enough with Mr. Hopper as an individual that I thought that I was impressed with his credibility.

[R. 790] I thought that—I think what—after we had this meeting in the breakfast room, I went up and got some message.

I believe there was a call from Mr. Zukowski and I belive [*sic*] I picked up the phone and called him and I said, you know, by the way, Pat, would you mind talking to Mr. Zukowski.

And he said sure, why not.

I'll be happy to tell anybody that I—what they want—you know, whatever they want.

I'll be happy to talk to anybody.

It was something like that.

Q And did you in fact call Mr. Zukowski on the 20th?

A I believe I placed a call to Mr. Zukowski on the 20th from my room at the Beverly Wilshire.

Q Was the call connected?

Did you talk to Mr. Zukowski?

Q And did you put Mr. Hopper on the line?

A Yes.

Q Was the Equity Funding letter discussed in this conversation?

A Well, I only heard one side of it.

But my impression was that—well, I [R. 791] know that Mr. Hopper was talking about Equity Funding.

Q And how long did the conversation last?

A I don't remember.

It didn't seem to me like it was very long.

I thought maybe five or ten minutes.

* * *

[R. 797] Q Now, returning to your meeting with Mr. Majerus, about what time did that meeting begin on the 20th of March?

A Oh, I think it was around 1:30, somewhere in there.

* * *

[R. 798] Q How long did you meet with Mr. Majerus?

[R. 799] A I think it was about an hour and a half.

* * *

[R. 801] I asked him if he had been involved in this.

He said, well, he had had—that he had had—that he had made up—that he had helped Pat make up some pencil ledgers, or something, at the request of Lloyd Edens, I believe it was.

And at that point he sort of dropped his head down and said, "I think I'm going to jail."

* * *

[R. 803] Q Now, on Wednesday, the 21st of March, did you have a call from Zukowski at III?

A I don't remember whether he called me or—I remember I did talk to Mr. Zukowski on the morning—at least it was the morning in California, the 21st.

[R. 804] Q And do you remember what you spoke about with Mr. Zukowski?

A Some of it, yes.

Q Can you tell us what you remember of that conversation?

A Well, it may have been in that conversation that he indicated that he didn't think much of Mr. Hopper's comments in terms of these allegations by Secrist but he said that—and he said that he thought there was less than a ten percent chance there was truth in these allegations and that he thought they were making a mistake in terms of—meaning the institution that he worked for was going to sell their stock.

He thought they were probably getting out at the bottom.

He indicated to me that they were planning to send commissions to Delafield Childs in the amount of $25,000.

I think that's what I remember, basically.

* * *

[R. 1127] Q Now, on the 23rd did you speak to anyone at III?

A Yes.

Q Who was that?

A Jerry Zukowski.

Q Did you speak to Mr. Baker on that day?

A I don't recall.

I thought I spoke to him the day before. I am not sure.

Q What did you tell the people at III on the 23rd?

A Well, I said, Jerry, I know that you think you made a mistake when you sold the stock, but I have talked to a few more people and they are tending to substantiate the story that the—of the allegations [R. 1128] that these other individuals had given to me.

And I said something like, well, maybe you didn't get out at the bottom or something to that effect and maybe that will make you feel better or something.

We were sort of joking and he said, well, it makes me feel worse, because we just went through our office here and we found out that some of the stock we sold was bought by our affiliate, John W. Bristol & Company.

And I said, well, if you want to have Mr. Bristol call me, why, I'll be happy to talk with him.

* * *

[R. 1134] Q Now, on the 24th, which was Saturday, did you have any conversations with Mr. [Anthony] Orphanos [a securities analyst with Dreyfus Corp.]?

A Yes.

Q Could you tell us about those conversations, please? Did you have one conversation or more than one?

A I think I had more than one but I don't recall exactly.

Q What did you say to him and what did he say to you?

A Well, I told him I had gone to the accountants, I believe.

I told him that or I was going to the accountants but—and that I was hoping the stock wouldn't that—or I think I indicated I didn't think the stock was going to trade any more, at least until the accountants could find out what was going on at the company.

And I told him—

Q Did you expect the accountants to do something after you had spoken to them?

A Yes.

Q What was that?

A I thought they would contact the New York [R. 1135] Stock Exchange and the SEC and ask those institutions or regulators to hald [*sic*] the trading until they could check into this.

Q Why don't you continue with your conversation ith [*sic*] Mr. Orphanos?

A I said to Mr. Orphanos that I would—well, I was looking for all the help I could get.

And that I was—I thought I would give him the names of some of these people I talked to.

And I gave him the number of Ron Secrist and I believe some of the others.

I am not sure whom but in any event, I did give him several names and phone numbers, people to call.

I think I gave him Pat Hopper and some of the others as well.

I suggested he call himself.

Q Was there any discussion at that time concerning whether Dreyfus had Equity Funding in any of the accounts that it managed or funds that it managed?

A Well, I think there was—I think he indicated they had some stock, I believe.

That is my best recollection that they owned some stock.

* * *

[R. 1136] Q Now, on the 24th did you also meet with Mr. Balint?

A Yes.

Q What was said at that meeting?

A Well, he came by my hotel and I said, well, should we go to dinner down here and—down the street?

He said, no, we'd better get out of this area.

So we went up about 20 miles down the coast and then we proceeded to have dinner.

We talked at great length about accounting for life insurance companies, how long he had been the accountant for Equity Funding and what his—what his—the—

Q How long had that been?

A I think they became the accountants [R. 1137] shortly after the company came to California.

It was about 1967.

JUDGE MARKUN: Excuse me.

Did you say 1967?

THE WITNESS: Yes. 1967.

JUDGE MARKUN: Thank you.

A (continuing) And of course also we talked about how they would—they were not any longer the accountants.

I believe they left and the last time they did an audit was '71.

It might have been '70.

I am not sure.
I believe it was '71.

* * *

[R. 1138] Q Now, did Mr. Balint indicate that he had heard of the fraud at Equity Funding prior to your describing it to him?

A Well, he didn't indicate that he had heard of the fraud.

Q In fact what did he say?

A Well, he say [*sic*] he couldn't understand how this kind of thind [*sic*] could have occurred when he was a partner in charge of the audit and when he had spent a lot of time over at Equity Funding and when I gave him a list or recited a list of 45 people that allegedly knew about it, he was quite astonished, particularly when I brought up Frank Majerus, whom he said he had just talked to the week before.

He did say that if management—if the top management of the company is in collusion, perpetrated a fraud, why it was conceivable that this could have happened, and he wouldn't know about it.

This was about a seven-hour conversation, incidentally.

Q Did you have your notes with you at that time?

A No.

I told him I had my notes back at the hotel.

[R. 1139] Q Did you discuss the substance of those things that were on your notes?

A Yes.

Q And Mr. Balint indicated to you that he had heard none of these things prior to that dinner meeting with you?

A Well, none of the things that pertained to allegations of improprieties and things of that sort.

* * *

Q Mr. Dirks, in this meeting on the 24th, was that the result of your conversation with Mr. Balint on the 23rd when he asked you to call him back at his house and after—one hour after he advised you to change hotels?

A Yes.

Q Now, on the 24th, did you also have a meeting with Mr. Spencer of Seidman and Seidman?

A Yes.

Q And did Spencer tell you that he would hold up certification of the audit and look into your allegations?

[R. 1140] A Well, in answer to my question as to what he would do about the certification of the audit, he said he would certainly look into this before releasing any certification or he said something like we'll have to look into it.

Q Now, on the 25th, did you have occasion to meet with Mr. Quinn?

A Yes.

Q Where did that meeting take place?

A At his hotel room, I believe at the Beveraly [*sic*] Wilshire Hotel.

Q And who arranged the meeting?

A Well, Mr. Orphanos, I believe arranged the meeting.

Q How long did it last?

A Not very long.

Just a few minutes.

At least in terms of any discussion about Equity Funding.

Q What did you say and what did he say?

A Well, he just said what's the story and I think I—I think I told him that that—you know, previously about the allegations and then I told him that I had had a—set up a meeting for Mr. Majerus, Mr. Hopper to meet with Mr. Blundell and after that meeting I'd arrange—I had reached Frank Majerus and asked him to call Mr. Balint and tell him [R. 1141] what he had told me in essence and that I then called Mr. Balint and he acknowledged Mr. Majerus had called him and so I told Mr.—in essence I said, you know, I did put the former controller of the life insurance company in touch with the former partner in charge of the audit there.

Q And did you identify these persons by name?

A I think I did.

I—I don't think it was—I don't think he was that interested in taking down names.

Q What was the import of this?

What was the importance of that?

MR. GREENWALD: The import of what, Your Honor?

MR. DIETZ: Of Mr. Dirks' statement that he put the former controller in touch with the auditors.

BY MR. DEITZ:

Q Did you discuss anything on that point?

A Well, I told him that I thought it was pretty significant that I had gotten the former controller of the life insurance company to call up the partner who had been in charge of the audit whom he knew personally and apparently they had a high regard for each other, and to have the former controller allege that there was—that there had been—well, of course, I didn't know actually what he said to the former controller, but I was assuming [R. 1142] what he said would have some—tend to put further doubts in the auditor's mind and perhaps get him to do something.

* * *

[R. 1150] Q And did you call Fidelity Management and Research in Boston?

A Yes.

* * *

[R. 1151] Q And what is your present recollection of that conversation?

Did you ask them whether they owned the stock?

A Well, I asked him if he had an interest in Equity Funding.

Q And what did he say?

A No, he did not.

He said he did not have an interest.

Q Did you ask whether they had an interest or whether they owned stock?

A Well, I always ask whether they have an interest—if they're not interested I don't ask people do you own the stock.

A [*sic*] Well, why don't you read on page 470, starting with the question at line 19?

A Question: How about Fidelity?

Answer: The same thing.

Well, Fidelity, they didn't own the stock so I really didn't give them the story.

* * *

[R. 1248] Q Going back to March 12th, Mr. Dirks, I would like to ask you some questions about that date.

Do you know a Mr. Herb Lawson?

A Yes.

Q You knew him on March 12, 1973, did you?

A Yes.

Q I believe you testified he was an employee of the Wall Street Journal?

A That's correct.

[R. 1249] Q Did you place a call to Mr. Lawson on March 12th?

A Yes, I did.

Q Where was Mr. Lawson located at that time?

A Well, his office was at the Wall Street Journal in San Francisco, where he was bureau chief.

Q Why did you decide to call Mr. Lawson on or about the 12th of March?

A Well, I thought that I would try to have somebody who could generate publicity about this investigation it—investigate with me or separately and I wanted to give him the allegations by Mr. Secrist in order that he could do something.

Q All right.

Did you reach Mr. Lawson on the 12th?

A No.

No, I—as I recall he wasn't there and I think—I may have left a message but I don't recall specifically.

Q Do you recall whether he called you back?

A No, he didn't call me back.

* * *

[R. 1259] Q All right, sir.

Now, on March 19th, which is a Monday, 1973, did you have occasion to speak to Mr. Lawson at the Wall Street Journal?

A Yes, I did.

I talked to him on the telephone.

Q Did you call him or did he call you?

A I had placed a call to him.

Q And—

A I believe I connected with him right away.

Q Do you recall how long that conversation lasted?

A I think it lasted for perhaps 15, 20 minutes.

Q And do you recall what time of day it was?

A Well, it was in the afternoon in New York, and I think in the morning in San Francisco.

Q Do you remember what you told Mr. Lawson?

A I told him that a former employee of Equity Funding had come to me and recited a long list of allegations about the creation of fictitious insurance at Equity Funding and that this involved creation of fictitious assets, fake death certificates, printing up fake certificates of deposit and other securities and that this former employee [R. 1260] had indicated that—that the fraud was being carried out by senior officials at Equity Funding Corporation in Los Angeles.

In summary, I recited the allegations that Mr. Secrist had given to me and suggested to Mr. Lawson that perhaps he would like to look into these allegations and see if he could get to the heart of them, and that I would like to cooperate with him in the investigation.

Q In the course of your conversation, did you happen to tell him about the conversation you had with Stanley Goldblum on the 12th of March?

A I think I mentioned that I had spoken—that the company had recently reported earnings and that Mr. Goldblum and I had had a conversation in which Mr. Goldblum said everything was going along fine and in substance denied the allegations.

Q All right.

Now, what did Mr.—what was Mr. Lawson's reaction to the story you told him?

A Well, he said that he—that he was pretty busy right then.

He was—he had to go to a Bank of America annual meeting the next day or two, and had to prepare for that.

He also said that he didn't know whether the—[R. 1261] he could look ito this himself because Equity Funding was located in Los Angeles and he would have to—possibly have to refer it down to Los Angeles to see whether they would be interested in looking into it.

Q All right.

Did Mr. Lawson indicate to you that he thought that he would be ready or that the Journal would be ready to print the story based upon what you told him?

A No, he did not.

* * *

[R. 1263] Q * * * Why did you relay the information or allegations that you had from Mr. Secrist and Mr, Goldblum to Mr. Lawson at the Journal?

A Well, I thought that if—in fairness to Mr. Secrist, if there was any truth in what he said, it was my responsibility to try to do what I could to help expose this alleged fraud and it seemed to me the best way to do it would be to go to a highly respected financial publication, to a journalist whom I personally knew, who I thought would—if he took this—these

allegations seriously he would investigate it and determine the truth of it and make it public.

* * *

[R. 1264] Q Did Mr. Lawson's reaction to your telling him the information had you had, make it seem to you that it was likely that the story was true?

* * *

A I think—the answer is no.

If anything was less believable—I might say when I first talked—started the conversation I said this [R. 1265] sounds like an unbelievable story, Herb, but—he didn't do anything to—to change that view of mine.

Q All right.

Now on March 19th, did you have occasion to speak to Mr. Ronald Secrist again?

A Yes, I did.

Q Did you call Secrist or did he call you?

A I called Secrist.

Q And—

A In Atlanta.

Q It was—he was in Atlanta at that time?

A Yes.

Q Do you recall how long your conversation with Mr. Secrist lasted?

A I think it lasted about 15 minutes.

Q Do you recall the subject of your conversation with Mr. Secrist?

A Yes.

Q And what was that?

A Well, we talked about—I think I told him that I had talked to Pat Hopper and that—on that day, and that I said that I was—I think I indicated I was investigating, that I was

looking into it, into the allegations and he—he said, "Well, you better hurry up."

I said, "Well, what do you mean by that? Have [R. 1266] you been talking to some regulators?"

He said, "Yes," and I said, "Have you talked to the insurance departments in the far west or the middle west?"

And he said, "The far east."

And he said, "And the SEC."

And—but he said he wasn't supposed to say that, this was not something he was supposed to tell me.

He was sort of hesitant about that.

Q So you understood from your conversation with Mr. Secrist that he or somebody had gone to the SEC with his information and that he or somebody had gone to some insurance department on the east coast with this information?

A Yes, I understood that, from what he said.

* * *

[R. 1279] Q On March 20, 1973 did you have occasion to speak to Mr. Herb Lawson at the Wall Street Journal again?

A Yes.

I called Mr. Lawson and told him I was [R. 1280] now in Los Angeles and I was wondering if he had had time to get started at all in his investigation.

I asked him whether he was still preparing for the Bank of America meeting and he said he was.

And he asked if I would be up in San Francisco sometime in the next few days and I told him I probably would and I would get together with him up there if I could and he said, fine.

Q Did Mr. Lawson indicate to you on March 20 that he was about to start an investigation of the allegations that you had told him about with respect to Equity Funding?

A No, he did not.

Q Did he indicate that he was about to print a story with respect to the allegations that you had passed on to him made by Mr. Secrist?

A No.

* * *

[R. 1334] Q Turning your attention to March 21, 1973 again, did you have occasion to speak to Mr. Bill Blundell on that day?

A Yes.

I spoke to him that day and I saw him that day.

Q Did you know Mr. Blundell prior to talking to him that day?

A No, I didn't know him.

Q How did you happen to speak to Mr. Blundell the first time that day?

A When I returned from my visit to Equity Funding he was—to my hotel, I received a message that Mr. Blundell had called me.

So I called him back and he said that [R. 1335] Herb Lawson of the Wall Street Journal of San Francisco had suggested that he give me a call because he—he talked to me about Equity Funding and he, Lawson, had said that the stock had been very active and dropped substantially and he wanted to come and see me.

Q What was Mr. Blundell's position in—as of March 21, 1973?

A He was the bureau chief of the Los Angeles bureau of the Wall Street Journal.

Q And in your telephone conversation on March 21 did you set up a meeting with Mr. Blundell?

A Yes, I did.

I suggested that I would be having a meeting with him at his convenience and he said he could come out to the hotel within an hour or so.

Q Did you agree to that?

A Yes.

Q Did he come to your hotel?

A Yes.

He came out and we had a meeting for an hour and a half to two hours.

Q Did you take any notes of that meeting, Mr. Dirks?

A No.

Bill Blindell [*sic*] took quite a few notes but [R. 1336] I didn't take any.

Q All right.

What did you tell Mr. Blindell [*sic*] during the meeting?

A I recited to him the allegations of Mr. Secrist in considerable detail and also told him that I met with Mr. Hopper and Mr. Majerus and I recited what they had to say in considerable detail and I told him I had been to Equity Funding and I recited to him what they had said to me about these allegations.

Q What you say in considerable detail, did you tell Mr. Blindell the allegations about the so-called Y business?

A Yes.

I told him about the allegations of fictitious assets and fake death certificates and the allegations that the company had printed up fictitious securities and that the officers of the company were purported to be engaged in this activity and the top officers of the company in particular were behind this activity.

I went through the names of all the people that Secrist had alleged to me were involved in the fraud.

I told—I showed him—I showed Bill [R. 1337] Blindell my notes representing conversations with Secrist and Hopper and Majerus and the people at Equity Funding and I gave him telephone numbers of Majerus and Hopper and Secrist.

I discussed the allegations as far as Bankers National were concerned and told him about this allegation about the sales force and all of these questions that Secrist had raised.

Q Did you withhold any information as to these allegations from Mr. Blindell?

A No.

I gave him everything I could think of at the time.

Q And was that in substance everything you knew as of the time or everything you had heard as of that time?
A Yes, it was.

Q With regard to Equity Funding?
A Right.

Q What was Mr. Blindell's reaction after you told him about all these allegations and the company's denial?
A Well, he seemed quite astonished by these allegations.
He said he couldn't understand how this [R. 1338] could possibly occur, the—he tried to question me on how this kind of an alleged scheme could—could be carried out and he said it didn't seem possible at all.

Q Did Mr. Blindell tell you he thought he could write a story based on what you told him?
A No, he didn't.

Q Did he indicate that he couldn't write a story based upon what you told him?

* * *

[R. 1339] A * * * I think he indicated to me that he couldn't do anything else he could come up with some sort of evidence or proof that these allegations had any substance and I took that to mean he was talking about writing a story.

Q Why did you tell Mr. Blindell all of this information and all these allegations?
A Well, I was hoping that he could investigate these allegations and publish a story about it, publicize the fraud if it existed.

Q And was your disclosure of this information to Mr. Blindell at the Wall Streee [*sic*] Journal an attempt to benefit your clients in the securities business?

* * *

[R. 1340] A Well, I don't think I was thinking about my clients when I decided to go to the Wall Street Journal or when I talked to Mr. Blindell.

I thought that if there were such a thing as a fraud of this magnitude, why, it would benefit anybody in the securities industry to have it exposed.

Q After you finished your meeting with Mr. Blindell did you believe that Mr. Secrist's allegations were true, Mr. Dirks?

A No.

He was a pretty experienced guy in the reporting business.

He seemed to throw even more cold water on it just by the way he was reacting.

* * *

[R. 1353] Q * * * Also on March 22nd did you have occasion to speak to Mr. Blindell again?

A Yes, I believe I did.

Q Did you call him or did he call you; how did the conversation come about?

A Well, I think I called him again.

Q You called him?

A Yes.

Q Why did you—

A Well, I further relayed back that I talked to Mr. Goldblum again that morning.

I think I was curious as to whether he was going to do or doing any checking and—

Q Do you recall what Mr. Blindell told you?

A No.

I don't really recall.

I think he indicated he—just—he was just beginning to make checks, I think.

Q Did he indicate it was based upon the additional information that you had from Mr. Goldblum he was ready to go ahead and print a story on the [R. 1354] Equity Funding allegation?

A No.

He didn't indicate that, no.

Q Did he indicate he still wasn't ready to print a story on anything to do with Equity Funding Corporation?

A I don't remember whether he indicated that, no.

He certainly didn't indicate he was ready to make—print a story.

Q And did the Wall Street Journal run any story on or about that date with respect to Equity Funding?

A No.

No, they did not.

* * *

[R. 1368] Q On March 23rd, 1973, did you have occasion to talk to the auditors or former auditors of Equity Funding or any of it's [*sic*] subsidiaries?

A Yes, I talked to two of the auditing firms.

I talked to the partners who had been or still were in charge of audits at Equity Funding.

Q And who was that that you talked to, Mr. Dirks.

A I spoked to Robert Spencer, partner at Seidman and Seidman and I spoke to Mike Balint, partner at Haskins & Sells.

Q Why did you contact Mr. Spencer and Mr. Balint?

A Well, it seemed to me that if there were any truth to these allegations, they ought to be made public as soon as possible and I remember that Stanley Goldblum had told me that the audit for 1972 had been certified and was going to be released shortly and I think he said it would probably be released the following Monday, which was the 26th, and so I felt that the best way to get this story out as soon [R. 1369] as possible, if there were any story, was to tell the auditors because they were about to certify that all the figures Equity Funding had assembled were correct figures and I felt they would have a very strong interest in—in any allegations that there was something wrong with these figures that they were about to certify.

So I felt that—and I also felt that the auditors would not only investigate very quickly, but also would—if they found they couldn't determine the truth of these allegations immediately, they would ask the New York Stock Exchange or the SEC or both, to suspend or halt trading in the stock, pending the time it took to investigate these allegations.

Q Now, when you spoke to Mr. Spencer at Seidman and Seidman, did he indicate whether he thought that the allegations you were relating to him were likely to be true or credible?

A No.

He indicated they sounded quite astonishing, incredible.

Q What about Balint, the partner at Haskins & Sells? Did he indicate that he thought that it was likely that the Secrist allegations were true or that they were credible?

[R. 1370] A No.

He was incredulous.

Q Did you have occasion to meet with Mr. Spencer in the course of the weekend?

A Yes.

I met with him on Saturday, thw [*sic*] 24th.

Q And did you have occasion to meet with Mr. Balint? during the course of the weekend?

A I also met with him on Saturday the 24th.

Q And did you relate to Mr. Balint what you had been told by the various former employees and officers of Equity Funding with respect to these allegations?

A Yes.

I spent about seven hours relating these allegations to Mr. Balint?.

* * *

[R. 1371] Q Mr. Dirks, with respect to Mr. Spencer, did you relate to Mr. Spencer the allegations which had been

made with respect to fraud at Equity Funding and the denials of those allegations by the officers?

A Yes, I did, although he didn't seem very interested in hearing them.

He seemed to be in kind of a hurry.

[R. 1372] He asked—since he didn't really have time to listen to them, whether he could make a copy of my notes and which he would keep in confidence and so I agree to—to let him make a copy which his associate did.

* * *

[R. 1376] Q Mr. Dirks, when we finished up yesterday, we were discussing the auditors and your discussions with the auditors on March 23rd and the followin [*sic*] weekend and as you recall, you testified that you had brought this information and allegations to the attention of Messrs. Balint and Spencer.

Why did you go to the auditors at that time, Mr. Dirks?

A Well, my objective was to try to determine the truth of these allegations and to publicize them and it occurred it had occurred to me that the—that the top management of Equity Funding had just told me that the auditors had certified the annual statement for 1972, and that they were about to release that certification publicly probably the 26th.

This was the 23rd, Friday afternoon, and that one way to try to get to the bottom of this was to present these allegations to the auditors and with the—my feeling [R. 1377] was that they would immediately look into them if they thought—if the allegations had any—any—even if they didn't have any real credibility on the face of it, they at least would have to make some investigation because of the magnitude of the allegations, and I felt that—I also felt that they would immediately notify the stock exchange and the Securities and Exchange Commission about the allegations and stop trading in the stock and that this would also serve to bring this thing to an immediate head in the sense that once the trading was halted, there would be—it would be important from everybody's standpoint including the company's to—to cooperate in pinning down whether there was anything to these allegations.

* * *

Q Mr. Dirks, did you have any impression or any [R. 1378] view as to whether your going to the auditors over the weekend following Friday, the 23rd, would have any impact on the trading in Equity Funding stock?

* * *

A It was my believe [*sic*] after I had talked to the partners of Seidman and Seidman and Haskins & Sells, specifically, that they were going to look into these allegations and that they were going to notify the New York Stock Exchange and the SEC about the—about the allegations and it seemed to me that in view of that, the stock would not open for trading because I didn't see how they could resolve this over the weekend.

It would take—it seemed to me it would take a day or two, at least, for them to look into it and so [R. 1379] I didn't think the stock would trade at least on Monday, Tuesday.

Q And on Monday the 26th, of March, did you find out whether the stock did open and did trade?

A Yes.

Shortly after ten a.m., New York time, I found out that the stock was trading.

Q And did the fact that the stock was trading on Monday, the 26th, lead you to any conclusion with respect to the likelihood of the veracity of the Secrist allegations which you had related to the accountants?

A Well, that made me further doubt the veracity of the allegations.

It appeared to me the auditors hadn't considered them to be at all worthy of serious investigation.

* * *

[R. 1381] Q * * * Now, Mr. Dirks, on Monday, March 26th, did you have occasion to speak to Mr. Blundell of the Wall Street Journal?

A Yes, I did.

Q How many times did you speak to Mr. Blundell during the day on March 26th?

A I spoke to him several times and I spent several hours with him personally.

Q Do you recall what time of day your first phone call was?

A As I recall, the first phone call I made to him was around 10:30 in the morning.

Q And do you recall what you said to him or what he said to you in the course of that conversation?

A I said to him that I had just run out of my hotel and I was in a state of panic because I had just learned from Mr. Ronchetti that the notes I had turned over to Seidman and Seidman on Saturday were in the hands of the top company officials at Equity Funding, and so I asked him if he could do something to help bring this to a—[R. 1382] to a head because apparently the accountants were not taking it at all seriously and I wondered if he could do something, perhaps publicize these allegations or something of that sort.

He said that he—he said, well, first of all, you know, a good reporter never turns over his notes to anybody, and he didn't know what he could do at that time, but that he would see what he might be able to do and to keep in touch with him.

Q This was all—that was said during the first conversation on the 26th with Mr. Blundell?

A That's right.

Q Did you have a later conversation with Mr. Blundell on the telephone on the 26th?

A Yes.

I talked to him again in the afternoon, I think around three o'clock or so.

Q And do you recall what was said in that conversation?

A Well, I asked him if he had been able to do anything.

He said no, he couldn't publish anything or write a story about it, but that he was in touch with the SEC and he won-

dered if I would be willing to meet with the SEC and I said I would, under his auspices, or based on his [R. 1383] introduction.

Q Did he tell you why he couldn't publish the story?
A Well, he said he still didn't have enough to go on, something to that effect.

Q Did he tell you who he had been in touch with at the SEC?
A I don't think he named anybody.
He said the three SEC people from the Los Angeles branch office were going to be coming over to his office in a little while and he wanted to know whether he could ask them if they wanted to meet with me and also with Pat Hopper and Frank Majerus, and he asked—I believe he also asked Pat Hopper who was with me at the time, if he would be willing to meet with them and he said he would.
So he said he would call me after the meeting—call us both after the meeting and let us know whether the SEC was—would want to meet with us.

Q Did he call you later?
A Yes.
He called later and said he had a meeting for about an hour with these three people from the SEC, and that they had said that they would be willing to meet with Hopper, Majerus and me, and I believe he gave—gave us the telephone number of Gerald Boltz, B-o-l-t-z, who was the—the head of the Los Angeles office of the SEC, to [R. 1384] call him at home.

Q Did you meet with Mr. Blundell later in the day?
A Yes.
After another couple of hours, we talked again and we decided to meet down at the—downtown near the Sheraton Hotel on Wilshire which we did.
That meeting included Pat Hopper, Bill Blundell and myself and we talked for several hours about this whole situation.

Q By "this whole situation," you mean the allegations with respect to Equity Funding?
A That's correct.

Q At this time, had you told Mr. Blundell everything that you had by way of allegation or information with respect to Equity Funding Corporation?

A Well, I think I had told him everything I knew as I received the information, but whatever—whatever was happening, whatever information I had and whatever I was—whoever I was talking to, I relayed all that to Mr. Blundell so by that evening certainly I had told him everything I knew and I was trying to see what he was doing.

He indicated that he had talked to all the people I had talked to and also some additional people.

Q And he told you that isn't—wasn't enough to [R. 1385] print a story?

A Yes.

He told me he still couldn't print a story about it.

Q After you had gotten Mr. Boltz's phone number from Mr. Blundell, did you call Mr. Boltz?

A Yes.

I called him immediately or at least I called him—I called him when I was told by Mr. Blundell that he might be home anyway, and I believe Pat Hopper actually called him and we both agreed to meet Mr. Boltz at the SEC the following morning, I think at nine o'clock, around that time.

Q And did you go down to the SEC on the morning of March 27th?

A Yes, I did.

Q And did you go voluntarily, without subpoena?

A Yes, that's correct.

Q And did you thereafter, before the SEC, testify with respect to the Equity Funding allegations?

A Yes.

I testified that day and for the next three days in Los Angeles.

* * *

[R. 1388] Q * * * Did Mr. Blundell of the Wall Street Journal tell you that he had contacted the SEC on Friday, March 23rd?

A Yes, he did.

Q When did he tell you that?

A I don't recall exactly.

It was sometime during that period I learned that he had called the SEC or that Herb Lawson had called the SEC on Friday.

Q Do you know who Mr. Blundell or Mr. Lawson called at the SEC on Friday, March 23rd?

A Yes.

It was Stanley Sporkin, I believe.

I'm pretty sure they called—yes, they talked to Mr. Sporkin.

Q Did Mr. Blundell or Mr. Lawson tell you whether they had relayed the Secrist allegations to Mr. Sporkin on Friday, March 23rd?

A Yes.

They told me they had briefly relayed these allegations.

Q Did the SEC call you on Friday, March 23rd?

[R. 1389] A No, they did not.

Q Did the SEC attempt to contact you on Saturday, March 24th?

A No, they did not.

* * *

Q Did the SEC contact you on Sunday, March 25th?

A No.

Q Did the SEC contact you on Monday, March 26th?

[R. 1390] A Well, I contacted them.

Q Thank you.

Mr. Dirks, what was your motivation in doing your investigation of the allegations with respect to Equity Funding?

A My motivation was to publicize the fraud if it existed and first to determine whether there was any truth to the allegations and in doing so, it became apparent that I had to talk to a lot of people and make—and publicize it as much as I could.

My motivation was to having heard these allegations from a former employee of Equity Funding, to try to determine the truth of them and in doing so, to—to publicize them and expose the fraud, if it existed.

Q Why did you want to expose the fraud if it existed? Why did you want to publicize it?

A It seemed to me it was—if there were truth to these allegations, it was a very—it was a very criminal thing going on that was going on underneath the noses of the regulators and it was hurting the public, it was hurting the securities industry and the insurance industry and it was something that was, if the allegations were true, was not only going on, but it seemed to be increasing in scope and it would have eventually involved other companies, that Equity [R. 1390a] Funding was already trying to acquire and said they were going—had indicated they would continue to acquire.

So it was something that had to be investigated immediately it seemed to me.

* * *

[R. 1403] Q In the course of your direct and cross-examination during the past few days Mr. Dirks, have you mentioned a number of companies and persons to whom you related all or a portion of the allegations with respect to fraud at Equity Funding?

A Yes.

Q Are there any other companies to which you related these allegations?

* * *

[R. 1404] A Well, there were quite a few others.

There was Chemical Bank, Schroeder Trust Company, Ford Foundation, Morgan Guaranty Trust Company, Steinhardt, Fine and Berkowicz.

There was Fidelity Corporation of Virginia.

There was McConnell and Miller.

There was Smith Barney Bayrock Advisers.

There was Standard & Poors, Oppenheimer and United Bank of Madison, which—Madison, Wisconsin.

There may have been others.

Those are what I recall at this moment.

Q Did you mention Loew's Corporation?

A No, I thought we had discussed Loew's previously. I did certainly talk to Loew's at great length.

[R. 1405] Q Was Loew's Corporation a client?

A No, they were not a client of Delafield Childs.

Q How about Fidelity Corporation of Virginia, were they clients?

A No.

We never did any business with them.

Q How about Bayrock Advisers, were they a client?

A No.

We never did any business with Bayrock.

Q How about Oppenheimer, was Oppenheimer a client?

A They were competitors.

Q How about the Steinhardt firm, were they clients?

A No, they were not.

Q How about Smith Barney, were they a client?

A No.

They were competitors.

Q How about the Ford Foundation?

A No.

Q Were they a client?

A No.

[R. 1406] Q How about the United Bank of Madison?
A No, they were not a client.

Q Did these people pay you for anything that you told them?
A No, they never did.

Q Did you expect them to pay you for anything you told them?
A No.

Q Did you expect them to become clients after anything you had told them?
A No.
I didn't think they would.

Q Did you, in the course of your investigation give a different story or give different portions of the allegations to people you spoke to depending on whether they were clients of yours or not?
A No.

Q Mr. Dirks, why didn't you go to the SEC before Tuesday, March 27th?
A Well, in the first place I heard the allegations from Mr. Secrist.
We discussed the regulators and specifically the SEC.
He indicated that several people at Equity Funding had talked to the SEC and that this [R. 1407] has not resulted in any serious investigation.
In fact, that the employees felt that the allegations had come back to the top management of Equity Funding was committing a fraud and secondly—then I expressed to Mr. Secrist at the time that I personally had similar experience with the SEC wherein I had related them information that was confidential and that this confidential information had been relayed by the SEC to business clients of mine which had resulted in my losing their business.
And consequently I agreed with Mr. Secrist that his idea that he would not personally go to the SEC was probably wise

under the circumstances and I indicated to him that I would not got to the SEC myself, rather I would go to the Wall Street Journal.

* * *

[R. 1665] Q Mr. Dirks, do you recall that on Monday, the 12th, you asked somebody at your firm to check your records to see which of your clients owned Equity Funding securities?

A I don't recall that.

Q Do you remember giving testimony before the New York Stock Exchange on April 4th, 1973?

A Yes.

MR. BONDERMAN: Do you have a page number?

MR. DEITZ: Page 36, Mr. Bonderman.

BY MR. DEITZ:

Q Do you remember being asked the following questions and giving the following answers:

Would you read outloud from page 35 with the question beginning "You also".

* * *

A "Question: At your lunch, you know, prior to talking to this individual, did you discuss Equity [R. 1666] Funding?"

"Answer: No."

"Question: You also mentioned that one of the things you were going to do was check the list to see if any of the clients had any of the stock?"

"Answer: Right."

"Question: Did you have that done for you on Monday?"

"Answer: I think I asked somebody to check our records, but I don't recall at what time during the day.

It had to be sometime before, I think, around 4:30."

"Question: And what was determined, that clients did have them?"

"Answer: It was determined that no mutual fund owned it, to my knowledge, because they were not allowed to own it.

"We keep a cross reference. The only way we could determine who owned it is because we checked with the client, we tried to ascertain what he owns, and I had my secretary record the names of their holdings in the file of that client.

"I also had her transfer the individual's holdings to a sheet which shows the names of the institutions [R. 1667] that own one stock, and so we checked that.

"I think there were three names or four. I'm not sure."

"Question: Can you recall the four names?"

"Answer: I'm sorry, but I think there were three.

"There was Boston Company, Institutional Capital and Sears Roebuck, but I should have mentioned earlier as regards when this individual came to me, I recall specifically one conversation I had had with an institution about it and I don't have to go to my records for that.

"I knew that there was one company that owned that stock and that was Boston Company and I'm not sure if I checked the records on Monday.

"In other words, I'm not a hundred percent sure, but I think I did.

"I must have."

Any more?

Q That's fine.

Do you remember being asked those questions and giving those answers, Mr. Dirks?

A Well, I remember being called in there on April the 4th to answer a lot of questions.

I think they were in a big rush and I was in a big rush, and when I used terminology like owning stock, it [R. 1668] was certainly not—that may have been the standard type of terminology when you talk to clients, because I explained to you earlier, Mr. Deitz, we didn't know who owned stocks.

Generally we ascertained whether they had an interest in them.

The institution doesn't normally say, well, we own this, we own that.

Generally they reflect that they have an interest, they may own it, they may have owned it and sold it, they may not own it and be interested in buying it.

* * *

[R. 1764] Q Why did you use the word "owned" instead of had an interest, in the book?

You are fairly consistent.

A Well, I—

MR. BONDERMAN: Excuse me.

I would like to object here on this.

[R. 1765] It seems to me, your Honor, that we spent most of the morning on this exact subject and the same exact thing.

Mr. Deitz has already had this question answered several times.

I don't think we would like to go through it again.

MR. DEITZ: Your Honor, it is a question that hasn't been asked yet.

I confronted the witness with inconsistent statements.

He told me in each of these instances that what was printed, owned, Mr. Dirks indicated to mean to have an interest.

I wondered why, and haven't asked him yet, why they used in the book—or—he used in the book the word owned instead of had an interest.

JUDGE MARKUN: Well, gentlemen and ladies, I think in point of fact that the question has been asked, perhaps not in those words, but in substance at least once by counsel and at least once by me.

However, I have not heard an answer that I can comprehend, so I am going to allow the question to be put to the witness one more time.

Will the reporter read the question back, [R. 1766] please.

(Record read.)

A Well, I think that's precisely the reason that Mr. Gross wrote it that way, because it is confusing that—I think, to the layman reader of a book about a pretty complicated event relating to the stockmarket, which very few people know much about in detail.

Rather than use have an interest and owned there, it seemed to me that that's the reason that it was used.

I didn't—I didn't see that that was a significant point to change just because it wasn't strictly true.

In other words, when I was reviewing the galleys or the initial pages of the book, as drafted by Mr. Gross, I thought that that was a literacy license in the sense that it was something that would make it clear to the reader.

JUDGE MARKUN: Did you consider the question of fairness to your former, current or potential clients in terms of being accurate, the difference between having an interest and owning?

THE WITNESS: No, I don't think I considered that at the time.

Q Why in these conversations did you ask at all [R. 1767] whether your clients either had an interest in or owned Equity Funding before telling them about what you had heard from Mr. Secrist and others?

MR. GREENWALD: Your Honor, I object.

We have had hours of testimony about the fact on the street, and I think everybody in this room who has any familiarity with the way investment advisers work, they do not announce—and this has been testified to; I'm not—they do not announce what they own.

They announce what they have an interest in.

Now, for Mr. Dietz at this point to ask this witness why didn't you ask them, when the witness has at least on a half dozen occasions indicated that that's not the way it is done, it seems to me, it is highly repetitious.

That's why we are spending so much time with this witness.

MR. DEITZ: Mr. Greenwald, you are objecting to a question that I did not ask.

JUDGE MARKUN: Well, I'm not sure that you got the drift of the question.

I'm going to ask the reporter to read it to you.

[R. 1768] (Record read.)

MR. GREENWALD: You are right, your Honor, I didn't get the drift of the question.

I don't understand it at all.

Laughter.

MR. GREENWALD: I don't have the foggiest idea of what Mr. Deitz is referring to.

I would object to the question on that basis.

MR. TANDET: Your Honor, I would also object because it was not testified to before by Mr. Dirks in the form that that question is asked.

JUDGE MARKUN: No.

I think, sir, to the contrary, there is at least some evidence indicating that he asked—he asked at least whether the client had an interest in Equity Funding.

So that part of the objection is clearly not well taken.

As to Mr. Greenwald's objection, that the question is unclear, I think it is clear in my mind.

I'll have to ask the witness, do you understand the thrust of the question?

THE WITNESS: Well, your Honor, I—

[R. 1769] JUDGE MARKUN: He's asking you why you asked either about an interest or ownership on the part of the persons you were contacting.

THE WITNESS: Well, I think I understand the question.

JUDGE MARKUN: All right.

Let us have your answer, please.

A In the first place, though, I don't believe I did ask in every instance whether they had an interest in the stock.

But in the cases where I did, I asked the question to see whether—well, as I have testified to, you don't really want to waste time of people who are busy in the investment world trying to invest money with securities they have no interest whatsoever in.

The inclination would be that they would spend a few minutes talking to you about the security.

That would be the reason for asking that question.

JUDGE MARKUN: But in this particular context, Mr. Dirks, you wern't [*sic*] inviting them to purchase the stock, were you?

THE WITNESS: No, I was not.

I was inviting them, your Honor, to listen [R. 1770] to these allegations and see what their reaction was to it.

And also as I testified earlier, your Honor, to see whether they would make checkings themselves in view of the greater resources they had, see whether they could come up with anything to substantiate these allegations.

* * *

EXCERPTS OF TESTIMONY OF GERALD ZUKOWSKI

[R. 1957] GERALD ZUKOWSKI,

* * *

Q Where are you employed?
A Boston Company Institutional Investors, Inc.

* * *

[R. 1959] Q Now, what is your position with III?
A My title is vice president.
I basically am a portfolio manager.

* * *

[R. 2276] Q Mr. Zukowski, I hand you Division Exhibit No. 24, which is a Xerox copy of a document.
Do you recognize that?
A Yes, sir.

Q Can you identify that document for us?
A This is—we had a chit system where you could put in for brokerage commission business to be given to a broker.
And this was a brokerage request in which I wanted to give Dirks four or five thousand dollars of commission business and I had—do you want me to go over this?

Q Why don't you read for the record?
A Yes, sir.

Q One item under reason, which is part of this division's exhibit.
[R. 2277] A Insurance company reports and recommendations.

Q Now, did you write that on this exhibit or cause that to be written on that exhibit?
A Yes, sir.

Q And did you direct Mr. Moore to execute this brokerage request somehow or did you prepare it yourself?

A I prepared it and it had to be approved by Tom—it was the first one I had ever prepared.

Q In the lower right hand corner it says approved by and it looks like initials of TC.

Is that Tom Courtney's initials?

A I believe so.

MR. MALAWSKY: I offer Division Exhibit 24 in evidence.

* * *

Q Now, in the lower left hand corner, requested by, is that your initial?

A Yes.

[R. 2278] Q On Division Exhibit 24?

A Yes, sir.

Q And the date appearing on the brokerage request, Exhibit 24, 31573, in the amount of $3,956.20.

A Yes, sir.

Q Now, can you explain the date and the—that amount that I just mentioned, how did that come to appear on that exhibit?

Q Yes.

The trader wrote that on there.

That was the—I would assume that he evidently transacted—made a transaction on that date for that exact amount.

Q Would you know what securities would have been the ones sold or purchased which would have generated those commissions?

A Well, at the time I got my first account and I was selling things left and right that would have probably been from one of the sales I made, but I am not certain.

Since I just gave the request to the broker—we don't have any strict policy on giving a broker—sales or commission business on a particular stock.

We bought a lot of—combustion engineering based on Delafield—Delafield analysts and we didn't [R. 2279] buy it all through them.

Q The item on the Exhibit 24, it says amount, four to five thousand, that would be dollars.

A Yes, sir.

Q Was that your request that he get commission business of four to five thousand dollars?

A Yes, sir.

Q And you write in firm Delafield Childs, correct?

A Yes, sir.

* * * *

[R. 2362] Q Will you tell us what was said?

A I did not want to talk to Ray.

I had two or three comments with Ray.

Ray asked me—he said—he says, you know, I'm liable to go bust on this thing, are you going to pay that commission business that you promised and I said, everything is totally out of my hands.

I said I don't know and I didn't want to talk [R. 2363] with him.

I didn't want to be there.

Q Was this in reference to the $25,000 business?

A We didn't say the amount.

He said the amount you mentioned—he may have, but he referred to the commission business that I promised him.

* * *

[R. 2366] Now, I think the understanding was that I would be able to pursue this area over his standing objection.

Since Mr. Bonderman is not here today I am raising this with you so the record will be clear.

* * *

EXCERPTS OF TESTIMONY OF LEO GOLDNER

[R. 4443] Good afternoon, Mr. Goldner.

Thank you for being with us.

State for the record your full name and present address.

A Leo Goldner, Edgewood Drive, Portchester, New York.

Q Where do you work?

A At Merkin & Company.

Q What sort of business is Merkin & Company in?

A Brokerage business.

Q What is your position there?

A I am a registered representative.

Q How long have you been in the securities business?

A 19 years.

Q Were you a registered representative in March 1973?

A Yes.

Q With what firm were you registered?

A Sweikart.

Q In the period March 6, 1973 through March 27, 1973 that would be through and including the time that trading in the security was suspended, did you make any purchases of any securities issued by the [R. 4444] Equity Funding Corporation of America?

A Yes.

* * *

[R. 4453] Q At the time you made 1,000 share purchase on March 26 did you have an impression about the financial condition of Equity Funding Corporation of America?

A Yes.

Q What was that impression or belief?

A That it was a company that was growing very rapidly and that the earnings for that year should be up appreciably

over the year before and that it was very solid insurance company.

* * *

[R. 4457] Q Mr. Goldner, as you sit here today do you recall whether on or before March 26, 1973 you heard any rumors from anyone in the world to the effect Equity Funding or any of its subsidiaries were being investigated by a government regulatory agency?

A The day I bought the stock?

Q Yes.

A No, I didn't hear any rumors before I bought the stock.

Q All right.

At the time you bought the stock were you informed Equity Funding was having accounting problems of any kind?

A No.

[R. 4458] Q At the same time, were you informed that Equity Funding had issued and was carrying on its books and records, fictitious life insurance policies and supporting records relating to such policies?

A No.

Q At the same time, were you informed that Equity Funding had been carrying on its books and records fictitious assets and earnings?

A No.

Q At the same time, were you informed that Equity Funding had publicly issued false and fraudulent statements of insurance premium income?

A No.

Q At the same time, were you informed that Equity Funding had publicly issued false and fraudulent financial statements?

A No.

Q At the same time, were you informed that officers and employees of Equity Funding had engaged in the fraudulent schemes and course of conduct described in my previous set of questions?

A No.

Q Had you been informed of one or more of those alleged improprieties, would you have purchased Equity Funding securities in March, 1973?

[R. 4459] A No.

* * *

[R. 4502] Q In March of 1973, up until that time, you had sold short stocks on four or five occasions?

A I follow you.

Q And you had definite reasons for selling short—

A Yes.

Q —instead of having a stock long, isn't that correct?

A Yes.

* * *

[R. 4503] Q Well, then let's go into that a bit, Mr. Goldner.

What are these handfull of stocks, these four or five that you referred to?

Which ones did you sell short?

A I don't have the foggiest idea.

Q You don't recall?

[R. 4504] A No.

Q And is that because you have traded in stocks so often that you don't recall these four or five instances you sold short?

A In 19 years I bought and sold a lot of stocks, yes.

Q For yourself and for others, isn't that correct?

A Yes.

Q And in any of those times that you sold, you—had you heard any rumors about a stock before you sold it?

A Yes.

Q And did all these rumors turn out to be true?
A No.

Q And did you go tell the broker or the prospective purchaser this rumor that you heard?
A I'm sure at times I did and at times I did not.
The prospective purchaser?

Q Yes.
A I'm sorry, sir.
You are really going around the bush.
Look—

[R. 4505] Q I am trying to go right to the heart of things, Mr. Goldner.
Maybe you are going around the bush.
A Look, I will answer your question.

Q Thank you.
A What I was—what I was trying to say is that the way the market system is structured here, you don't meet the buyers of your stock and you can't physically go on the floor because these are unknown people to you, unless you do a great deal of checking to find out who they are.
And when you are buying and selling stock a lot, you do not know who is buying your stock.
It is a very impersonal thing.
So regardless of who or how I feel philosophically about that statement, in a practical matter you can't tell the buyers of the stocks the rumors because you don't know who they are, which is the point.

Q And there is no way you can even get it conveyed to any prospective purchasers, is there then?
A Yes, you can.

Q How?
A By informing your broker in the floor [R. 4506] why you are buying the—or selling this stock how—so that they can tell the other party the reasons you are buying or selling it.
If you feel that is important to do.

Q And have you done that in all instances when you sold stocks based on rumors?

A No, I have not.

* * *

[R. 4507] Q Is it fair to say that in the securities business there are frequently rumors about securities and companies?

A Yes.

Q And do a lot of these rumors turn out to be baseless?

A Yes.

Q Can you think of a time in your 15 years, 19 years, in the securities business, where prior to sale or purchase of a security, disclosure was made to your broker and asked him to disclose to the contra-broker a rumor which you had heard of the company?

A I said I haven't done that.

Q Is it common for people in the securities business who hear rumors about companies to try to get them published before they trade?

A You mean if someone hears a rumor, they should ask that the company publish that information or someone publish it before they act upon it?

[R. 4508] Q Is that common, yes, to your knowledge?

A It is becoming more common.

Q Was it common in 1973?

A No.

* * *

[R. 4509] Q Mr. Goldner, on occasions when you heard rumors about a company, did you ever report those rumors to the SEC?

A No.

I would be on the phone all day probably.

Q That's because there are so many rumors floating around in the market?

A Many, many rumors, yes.

Q And that was true in March of 1973, wasn't it?

A Yes.

* * *

EXCERPTS OF TESTIMONY OF MALCOLM MACKAY

[R. 6654] MALCOLM MACKAY,

* * *

[R. 6656] Q Would you tell us, please, who constituted the hierarchy of the New York State Insurance Department in March of 1973?

A Yes, sir.

The superintendent of insurance, who is the first person in the department, was Benjamin Schenck.

I was the first deputy superintendent, which I think you could roughly describe as the chief administrator of the department.

* * *

[R. 6670] A I don't remember whether—whether it was on the 7th or the 8th that Mr. Krowitz and I discussed the matter.

Others and I discussed the matter.

We decided that we should inform the California and Illinois Departments of Insurance.

As I recall now—and this is vague—Mr. Secrist came to us in strict confidence, and we felt that we had to contact him and receive his permission before we contacted the California and Illinois Departments.

I think we did that starting on the 7th but had trouble finding him.

That was my recollection.

So I assume that on the 8th we did receive permission and we called the California Department, Mr. Christy Armstrong, whom many of us have had contact with.

And he called the Illinois Department.

You are dealing, basically, with an Illinois company doing 40 percent of its business in California.

That's why we chose that route.

* * *

EXCERPTS OF TESTIMONY OF ROBERT BERTRAND

[R. 6817/6818] ROBERT BERTRAND

* * *

[R. 6819] Q And prior to your going to private practice, what did you do?

A I was a Deputy Superintendent of insurance for the New York State Insurance Department.

* * *

[R. 6829] A I recall my concern at the time was whether or not what Secrist was telling the department was, you know, reliable, whether he was reliable.

I recall asking specifically whether he was credible, whether his story was believable and so on.

And I recall Mr. Krowitz telling me that they had taken him back and forth and around and around and he had always come out in the same place.

The crux of it was that the bureau staff was convinced that he was telling a real story, that it wasn't—that he was not making it up or imagining what was going on.

* * *

[R. 6851] Q * * * Now, did you have anything to do with calling Christy Armstrong?

A Yes.

After the events that we talked about earlier on March 6 and March 7, and further discussions that we had in the department—

Q Now, who is "we"?

A I would say the bureau staff and myself.

Q Who would that consist of?

A Mr. Krowitz, perhaps Mr. Alpert, and I don't know who of Krowitz' subordinates were actually involved in some of this day-to-day stuff.

But I recall clearly that at least Krowitz and I were involved in determining what we should do next.

And in view of the fact that Equity Funding Life was—had its principal offices in California, we made a decision to notify the California Insurance Company—Department, because they were on the scene and because we were very well acquainted with Christy Armstrong and the kind of person he was and so on.

So we telephoned Christy Armstrong or I believe Mr. Krowitz did, after it was decided that [R. 6852] this was what was going to be done, to apprise Armstrong of what the situation was.

Or what we knew of the situation.

Q To give your version of how—or what—at least Mr. Krowitz' version of what Mr. Secrist had said?

A That's correct.

Q That's correct?

A That's correct.

Q And were any opinions given at that time as to the truth or falseness of what Mr. Secrist had said, if you know?

A I don't know if any opinions were given.

I do know, however, that the feeling in the department at that time was that we thought Secrist was telling us the truth.

* * *

[R. 6928] Q Mr. MacKay testified yesterday in response to a question by me that he did not alter his view that the Secrist allegations represented an incredible, but theoretically possible set of facts until sometime in April of 1973.

In light of that testimony by Mr. MacKay, would you have a judgment as to the earliest date on which it was your view that the Secrist allegations were not only possible but probably true?

A I think I felt that way the afternoon of the 7th when I had a conversation with Mr. Krowitz.

* * *

EXCERPTS OF TESTIMONY OF JAMES STEEN

[R. 6972] JAMES STEEN

* * *

[R. 6974] Q What was your title or position when you were so employed by Illinois?

A Initially I was Deputy Director of the examinations branch, and then—that was from October of 1972 until July of 1973; from July of 1973 until December of 1974, I was Deputy Director of the financial regulatory branch.

* * *

[R. 6989] We decided to send a team of examiners in to the—into Equity Funding Life Insurance Company on Monday, March 12.

* * *

[R. 7002] Q Now, why was Mr. Doyle selected to go to California?

A He was one of our senior examiners and probably the best field examiner in the life division [R. 7003] of the examinations branch.

Q What about Mr. Fowler, who you also said you spoke to on March 9th?

A Fowler had been a field examiner working on actuarial matters and had since been transferred to the Springfield office to work on actuarial matters from within the office.

* * *

[R. 7035] JUDGE MARKUN: What was that policy?

THE WITNESS: In this case, we determined that we were going to investigate under the guise of a routine examination and if there turned out to be substance to what he had been told, to the allegations, then we would make them known.

If they turned out to be without substance, then we would issue our regular routine examination report.

* * *

[R. 7081] Q By the way, Mr. Steen, with respect to a company of the size of EFLIC, how long would it normally take to do a routine examination?

A A month to two months probably depending upon the manpower that was directed to it.

* * *

[R. 7088] Q Isn't it a fact that Mr. Secrist sounded rational and was believable during the course of your conversation with him on March 21st?

A Yes.

Q Did you gain the impression from his remarks and statements about the fraud at Equity Funding that he knew what was going on?

A He seemed to.

* * *

[R. 7097] Q By the way, by March 23rd there was no discussion about discontinuing the examination, was there?

A Discontinuing the examination?

Q Yes.

A No, not at all that I can recall.

Q In other words, on that day, or certainly by that day, was—it was ever the intention of the department to continue the investigation until you either found something wrong or you confirmed that nothing was wrong, is that correct?

A And issued our regular routine report, that's right.

* * *

EXCERPTS OF TESTIMONY OF CHRISTY ARMSTRONG

[R. 7252] CHRISTY P. ARMSTRONG

* * *

Q Your position with the California Department of [R. 7253] Insurance?

A I am the chief insurance examiner.

* * *

[R. 7291] Q Now, Mr. Armstrong, referring to this single page of notes of Exhibit CC on the 9th when you talked with Mr. Steen, do you remember having some discussion with him about how California would interface or interact with Illinois in this examination?

A Well, I recall that we tried to plan some strategy in that Illinois would come in first and then we would send a man on later so that it wouldn't appear that we just were jumping on this company with a ton of bricks, so to speak.

Q What was the reason or theory behind the planning or strategy for making this examination, as you [R. 7292] recall?

A We didn't want to alert the company for fear that they might start destroying records.

Q You wanted to make the examination appear as routine and ordinary as possible?

A Yes, we did.

Q That was to conceal from Equity Funding any basis for suspicion on their part that you were aware of these allegations?

A That was our strategy.

Q This was the strategy that you worked out with Mr. Steen?

A Yes.

Q Did you on the 9th indicate to him a date on which California would join in the examination?

A As I recall, I said a week or 10 days after the men were there, we'd have Mr. Rouble represent this state in Zone 6.

* * *

[R. 7424] Q Mr. Armstrong, do you normally keep penciled notes of every known conversation you have during the course of your official duties at the California Insurance Department?

A No, I don't.

Q May I ask you then what prompted you to keep the notes which with a few exceptions represented typed or printed III Exhibit Z to BBB?

A Actually, there are two reasons. One, because I had prior dealings with Mr. Goldblum who was the number one man in the organization and I had reason to question his integrity and the second was that the source of the information, that is, from Mr. Krowitz, led me to believe that this would develop into a case in which there would be litigation. So that the answer to your first question really is that if I find that we are going to be involved in litigation, that is, seizure, I try to maintain fairly complete notes.

* * *

[R. 7432] Q When you heard the allegations the first time from Mr. Krowitz, did you have an impression or a reaction as to whether the alleged scheme was technically feasible, given what you knew about the life insurance industry at that time?

A Yes, I reached the conclusion it was feasible.

* * *

[R. 7453] Q Could California have conducted a routine regular examination?

A Yes. We have the authority to do that.

Q Of EFLIC?

A Yes.

Q Were the procedures for a triennial or routine examination by Illinois officials substantially the same as those California followed?

A Yes, they are.

Q And were the procedures in either or both jurisdictions such as would have in your opinion uncovered the kind of fraud that Secrist alleged to have existed at EFLIC if there hadn't been some sort of informant such as Secrist or other employees?

A Yes. I believe we would have found at least a shortage of assets. There's no doubt in my mind that we would have uncovered the assets.

* * *

[R. 7454] Q But apart from the shortage or actual absence of assets of that kind the routine examination would have uncovered, would it have uncovered the matter of bogus insurance, assuming that the records were adequately falsified?

[R. 7455] A That would have naturally followed. The fact that the assets were not there, why—the question would be: Why did the company create such an asset on its books? And it would have naturally led to this operation in my mind. There's no doubt in my mind that in the course of a normal examination we would have found both the absence of the assets and the fact that the reinsurance was—that the business in force and the reinsurance on it was absolutely bogus.

* * *

EXCERPTS OF TESTIMONY OF LAWRENCE BAKER

[R. 7457] LAWRENCE COLBY BAKER

* * *

[R. 7458] A * * * In 1971 I was appointed as chief deputy insurance commissioner for the State of California.

* * *

[R. 7528] Q What was your state of mind by the end of that week, the 23rd, about the allegations of Secrist?

A It seems to me that there was a growing likelihood there was something seriously wrong at Equity Funding and there might well be some kind of fraud going on.

* * *

EXCERPTS OF TESTIMONY OF EDWARD GERMANN

[R. 7595] Q Would you state your full name and home address for the record, please.

A Edward Germann, 18725 Covello Street, Reseda, California.

Q Your business address, Mr. Germann?

[R. 7596] A 600 South Commonwealth, Los Angeles. California Department of Insurance.

Q Will you tell me what your present position is with the California Department of Insurance.

A Division Chief, Surveillance and Analysis Division.

Q How long have you held that position?

A Since about 1966.

* * *

[R. 7645] Q Did you have a conversation with anyone else on the 8th of March relative to Equity Funding?

A No.

Q Let's turn to the 9th then.

What do you remember as to any conversation on the morning of the 9th.

A I probably called Immigration and checked up on the passport there.

Q After that?

A I got a call from Mr. Bertz by—or I phoned Mr. Ogg and set up a time to come over to the SEC which was about 2:00 o'clock.

Q Did you go over to see Mr. Ogg at 2:00 o'clock then?

A Yes.

Q Where did you meet with him?

A In his office.

* * *

[R. 7646] Q Was anyone else present when you met with Mr. Ogg?

A Not at the beginning.

Someone—one or two people came in near the end and sat down.

Q How long did the meeting last?

A 45 minutes.

Q When during the 45 minutes did anyone else join you and Mr. Ogg?

A I would say maybe a little after 2:30.

Q After the first half hour?

A Yes.

* * *

[R. 7647] Q Was that the first occasion you ever met Mr. Ogg face to face?

A Yes.

The first time I think I had been to that end of the building.

Q Would you tell me in as much detail as you can exactly what you said to Mr. Ogg with reference to the allegations you had heard the previous day about Equity Funding?

A Well, I told him we had this report from someone who—we had this report from the New York Department that some employee from the New Jersey company had come in to say that there were things going on in the company that were not right and that it took the form of faked policies, falsification of confirmations about mutual funds or falsification of mutual funds and that there was faked bank certifications.

That was essentially what I told him.

Q Excuse me—

A And that these people were getting ready to leave the country, the report we had, and started to get sticky.

Q With reference to your report to Mr. Ogg on [R. 7648] faked insurance policies, did you discuss or mention the reinsurance aspects?

A Yeah.

Q What did you say about that?

A Well, that they had this thing where they would reinsure them up to the other companies and make it appear that they had written them, to make it appear that they were doing a lot of buisness and get the commission, 160 per cent commission, that O'Regan and Armstrong had talked about.

I told him too that there was some fellow with a name like Wieland that has a file, some kind of a file or tape that we ought to try to find, to explain how it was done.

Q What did you say to him about this fellow named Wieldnad or something like Wieland?

A That he supposedly had a piece of evidence somewhere.

I wasn't sure what it was and wasn't even sure how to spell his name or what it was, but it was a name like Wieland.

Q Did you identify it as a tape that he had?

A I am not sure whether I called it a tape or what.

I know I talked about it because it is easy to [R. 7649] remember the Y file and Wieland.

Q Did you refer to it as the Y file?

A Yeah.

It was called the Y file.

That was the only thing I knew it by at the time.

Q Did you tell him anything about whether you understand where Mr. Wieland might be located?

A I know my notes say "L.A.," but I carry him out of West L.A., somewhere in West L.A.

Q And you told Mr. Ogg that Mr. Wieland or someone with a name like Wieland was a former employee of Equity Funding?

A I told him who?

Q Did you identify this person as a former employee of Equity Funding?

A You mean the one with the Y tape?

Q Yes.
A Yes.

Q Did you give Mr. Ogg any explanation of how you understood the reinsurance would work, beyond the fact that they were relating to fake policy reinsuring, do you explain how the Ponzi scheme, I think was the phrase in your notes with Mr. Armstrong, worked?

A I don't think I went into any special detail [R. 7650] about that.

The main point I was trying to make to Mr. Ogg was about the indication that there was some falsification with respect to mutual funds involved.

In other words, that would be his main interest.

Ours was incidental with the insurance.

Q What did you tell him, as best you recall, about the allegations you had received regarding faking of records on the mutual funds side?

A Well, that we had the word that there were fake confirmations of mutual fund sales or fake mutual funds.

I was not exactly sure what it was, but it was some kind of phony transactions going on involving mutual funds.

Q What did you tell him about the source of these allegations, beyond identifying that there was some informer who had gone to the New York Insurance Department or the Insurance Department of New York and the Insurance Department of California?

A I couldn't tell him a whole lot.

I just told him I understood it was an employee from the company back in New Jersey and that—I notice in my notes it didn't mention anywhere, but I am positive that I mentioned the name, but I told him I wasn't sure, but [R. 7651] it was a name like "Secret."

Something like that. I wasn't sure of the name.

I wasn't real sure of the fellow's job, what kind of position he held except he was some kind of an executive with this company.

Q Your memory is clear that you told Mr. Ogg that the informer was an executive with the New Jersey Life Insurance Company or a former executive?

A Yes.

That's the way I thought of it and that's the way I told him about it.

Q Is your memory also clear that you also told Mr. Ogg that the name was something like "Secret"?

A Yeah.

Because I never really did get a good fix on it. Otherwise, I would have written it in my notes, but I just carried in my mind it was something like "Secret."

Q Did you tell Mr. Ogg anything more about the faked mutual fund records than you have already mentioned?

A No.

I don't think so.

Q What was your purpose in going to Mr. Ogg to give him this report?

A I wanted to get the assistance of the—

[R. 7652] Oh, I know another thing I told him. It wasn't about mutual funds.

Anyway, I wanted to get their assistance at their end, the SEC's end, in checking, checking out whether there were faked mutual funds or whether there were fake confirmations or whatever was going on about mutual funds because I foresaw that we might have troubles if we went into the insurance company—where our jurisdiction goes, we wouldn't have any trouble going into the life insurance company and looking at their records, but I figured as soon as we tried to get outside the insurance company to trace transactions, particularly with respect to mutual funds, that we would encounter a lot of trouble and problems and I wanted the SEC to go in from their side, the mutual fund side, whoever they had to go through, managers or the fund itself or whoever kept the records to determine what could be determined at their side while we could check from our side in the insurance business.

So I was asking for them to undertake to do that, work with us until we could start an exam immediately.

We wanted them to work with us and that was the main idea.

Q You told them that the California Department [R. 7653] was going to be starting an examination immediately?

A Yes.

Q You mentioned, before your last answer, that you remembered something else you had told him.

What was that?

A Oh, about the fact that we wanted to establish this, you know, this as expeditiously as we could without a lot of difficulty going from one corporation to another and beyond our jurisdiction possibly because we would probably have to act on this merger when it was filed and it hadn't been filed yet, but even—but we would have to have the case pretty well documented and put together inside of 60 days.

Otherwise the law says the transaction is automatically approved unless you disapprove it within that time.

In order to disapprove it, we would have to have it pretty well locked up.

Q When you had finished telling Mr. Ogg about the allegations of phony insurance and reinsurance and false records of the mutual fund share stock side, falsification of bank certificates, did he say anything to you to indicate that he had any familiarity with any of those kinds of allegations?

A Yes.

[R. 7654] He said they had had some kind of previous reports about irregularities at Equity Funding or reports like that, to that effect.

I was kind of surprised.

Anyway, that is what he said.

Q What did he say, if anything, about what had developed from those previous reports?

A I don't know as he characterized what had developed.

He just said they had those kinds of reports before, had checked them out, is all he said.

Q Did he make any other comment about those alelgations of fraud?

A You mean the ones that they had?

Q No.

The ones you reported.

A The ones I am talking about?

Q I am saying if he heard that kind of thing before, if that is a fair summary of what he said then.

A No.

Q Did he say anything else?

A No.

We did a lot of talking, but I don't think of any special response, particularly with respect to fraud [R 7655] in any way.

Q In connection with your statement to him that the Insurance Department had begun an immediate examination and that you hoped to get the SEC's cooperation in examining from their viewpoint, what did he tell you?

A Well, the end result of what he told me was they could not get on it for a couple of months.

This was in March.

I think something like July 1st or some date months away.

Q Did he indicate a willingness to cooperate with you?

A I don't know if it was a willingness.

He was interested.

He expressed an interest in it, but I don't know if I would call it a willingness to cooperate really because I was kind of surprised when he came out with the length of time that it was going to take.

I don't think I considered that as a willingness.

Q To the best of your recollection, how long did he estimate it would be before the SEC would be able to enter into any active work on these allegations?

A At least two months, maybe three.

Q Did he give you any reason as to why they [R. 7656] couldn't get other—couldn't get to it before then?

A I don't recall any language, but I believe it was because they had other things, other work.

By "they" I don't really know who "they" would be.

I know or I observed that Mr. Ogg and his people that came in to go with him—I had been down I think a week before observing some of the arguments in the commodity cases, so I knew they were all busy, so maybe I just understood that they were pressed.

I am not really sure what he said as to the reason why.

Some way I understood it was because they were busy.

Q Did he indicate to you that he or anyone else at the SEC would take action on their own on the basis of your report?

A No.

Q I mean any action until 60 to 90 days later?

A No.

* * *

[R. 7710] Stopping there for a moment, as of the time you went to see Mr. Ogg on the 9th, were you not aware that the Insurance Department of California had already been in communication with the Insurance Department of Illinois to begin an immediate convention examination?

A Yes.

Q Did you tell Mr. Ogg, when you saw him on the 9th, that this California department was going to proceed then and there as soon as possible with an audit examination?

A Yes. We were going to start.

* * *

[R. 7717] Q Mr. Germann, when the Secrist allegations were first reported to you, what was your reaction?

A You know, that it was startling and important.

Q Did you take the allegations seriously?

A Yes.

Q Did you formulate at least a tentative hypothesis of whether or not they might be true?

A What do you mean by that?

Q Did you have an impression as to the credibility of the allegations?

A Yeah. I figured, you know, it could be. Everybody was so excited about it.

Q Who is "everybody"?

A O'Regan and Armstrong and evidently New York.

[R. 7718] Q You say "evidently New York," you never spoke to them, did you?

A No. That is why I say "evidently".

Q Did O'Regan and/or Armstrong say anything to you which led you to conclude that New York was excited?

A Well, the fact that they had telephoned us and the fact that our people had gotten in touch with Illinois to get started on an exam, the whole atmosphere was, you know, they were exicted and they recognized that, you know, this could very well be true.

* * *

EXCERPTS OF TESTIMONY OF MORTON FIELD

[R. 7751] Q Mr. Field, would you state your full name and address for the record, please.

A Morton R. Field, 1901 Avenue of the Stars, Suite 1500, Los Angeles, California.

Q What is your profession?

A I am an attorney.

Q What is the name of your law firm?

A The name of the firm is Goodstein, Coaks & Field.

Q Would you please at this point trace your career for us since the time you got out of law school?

A Well, I got out of law school in 1948 and I joined the staff of the SEC at that time in Chicago and I remained in the Chicago regional office and some of its branch territories until 1950, at which time I was transferred by the Commission out here to the West Coast into the Los Angeles branch office.

I remained with the Commission here until 1952, [R. 7752] at which time they were having a reduction in force and the gentleman who came out with me from the General Counsel's office who transferred out with me, was removed and I was thought to be next, so I at that time elected to resign and I went out into the practice of law. I practiced for myself up until around 1955.

I had a partnership with another friend of mine, Raymond Wallenstein. The firm was known as Wallenstein and Field and we practiced together until I joined my present firm on May 1, 1973.

Q Does your practice, your private practice of law, involve the Securities [*sic*] area?

A I would say my practice of law since about the middle of the 1950's has been exclusively in the securities field.

Q Do you have any particular feelings or did you have any particular feelings in the 1950's and the 1960's as to your duties as a private practitioner to report instances of miscon-

duct or potential misconduct to the Securities and Exchange Commission when they came to your attention?

A I did.

Q Would you describe for us why you had such view or such feeling?

A The feelings, when I arrived out here to California [R. 7753] when I was with the Commission, this area, Southern California, was just like what you saw in the old western movies, a wild barron [*sic*] area here. It was a very unsophisticated area. You had a condition of people who committed fraud in other parts of the country, they found a haven here in Southern California.

So, in practice, in the securities practice, you had to be very careful with whom you were dealing, because you could never get too much of a line on the background of individuals, especially if they came from another part of the country and in order to try to build the credibility of the area somewhat, if anybody came in that indicated or at least appeared to me they may be perpetuating a fraud or may be involved in any kind of illegal activities, I did have occasion at every instance to call the local office of the SEC and advise them of that and sometimes I used to call the California Corporation Commissioner's office as well.

Q Were you acquainted during the 1950's and the 1960's with the staff personnel here in the Los Angeles offices of the Securities and Exchange Commission?

A Yes, I was.

Q Turning to the 1960's, who did you know in the office here in Los Angeles?

A Well, I knew Frank Kennemer; I knew Charly Burr; [R. 7754] Rudy Reinchild was a good friend of mine, Charly Margrin.

I am trying to think of somebody else. I knew a Art Bergman of San Francisco; Art Pennekamp was a good friend of mine, because he was the regional administrator up North.

But locally here those were the individuals that I knew and had contact with in the local office.

Q What was Reinchild's position here in Los Angeles back in the days when you were with the office?

A In those days Rudy Reinchild had the title of being the head of the broker-dealer section for the branch office here and then he later became the assistant regional administrator. I remember that.

* * *

[R. 7767] Q * * * What was the next contact or incident that you had involving the Equity Funding people?

A Well, our offices at that time were located at 6505 Wilshire Boulevard and right next door to our offices was a building owned by Mr. Herbert Glaser, the same Herbert Glaser I testified to earlier.

In that building was his law firm, Glaser and Glaser, and in that locale we all ate in one, the only restaurant around at that time there. I think it is Niblers, right on the corner of San Vicente and Wilshire Boulevard. It's a coffee shop with tables close together and had [*sic*] occasion to be going in there for lunch and the group that would come from Glaser and Glaser's office would come down and sit down in the coffee shop there. They would start talking and start talking very loud and what they would be talking about automatically made people, say, at my table immediately become quiet and start listening, because the conversation would go along, "Well, the stock is down now. We've got a registration statement due to come out next week, but Stanley says the price will be up there. He'll see to it that the price will be up this week and bring the offering next week."

[R. 7768] Language like this and conversation like this would go out and loud enough for people around to hear it and, of course, anybody sitting with me, knowing that I was always interested in the securities business, would immediately look at me and smile and stop and I, obviously, would be listening to the conversation.

Those conversations I used to also report back to the staff down here in Los Angeles.

Q When you are saying "staff," are you referring specifically to the SEC?

A I would always call Rudy. I would call Rudy on it, right.

Q Did these conversations occur more than once during the late 1960's?

A Oh, yes.

As I say, anytime you were there, it just seemed that the conversation, you can just hear it and it was being about Equity Funding there [*sic*].

Q All right.

A The next I remember in the '60's, this would have been more towards the late 1960's, I was having lunch on Hacienda Boulevard with some business people and during the course of the lunch one man there, they were commenting about "head hunters," each particular businessman was talking about the different agency or the different "head [R. 7769] hunter" he uses in acquiring personnel and one of the gentlemen at the lunch made the statement that his "head hunter" told him, "Beware, don't hire anybody from Equity Funding, beware."

Of course, that put my ears up, because Equity Funding is something that I had heard about and come in contact with and it was after that particular meeting, and I did call that into Rudy Reinchild, that I did give—

Q Excuse me, let me interrupt for a second.

A Sure.

Q You say that you called Mr. Reinchild and told him about this comment?

A I told him about the comment, right.

Q At the time did you have any great recollection of what that comment was that you testified to today?

Do you know any of the details?

A No details, because the man is repeating what his "head hunter" told him about warning him not to hire anybody

from Equity Funding, be careful of anybody from Equity Funding or words to that effect.

It was a warning type of a statement.

Q And you called Mr. Reinchild and told him what you had heard?

A Yes.

[R. 7770] Q What was the next thing that happened?

A Well, I myself had alerted everyone of my corporate clients, do not hire anybody from Equity Funding without checking with me.

I did advise every broker-dealer that was represented by our office and by me at the time there that they should not solicit anybody to buy or sell Equity Funding stock and the only transactions to have in the stock would be unsolicited agency transactions.

As a result of what I told my clients, one client represented a man by the name of Mr. Mercado or words to that effect, as a possible candidate for a job in the accounting department of the company, but in view of the fact he was with Equity Funding at the time and in view of my order not to hire anybody from Equity Funding without clearing with me, they sent him over to my office to be interviewed and this was late 1971.

This gentleman had a position in the accounting department of Equity Funding. I think he was still employed at the time.

I asked him why he was leaving or about to leave Equity Funding and he told me that he was scared and I said, "Would you elaborate on that", and he did tell me that Equity Funding at that time was negotiating to acquire a life insurance company in New Jersey and he said that if [R. 7771] that acquisition fell through that Equity Funding would fold and he was scared.

I said, "Well, if it fell, why would you be scared?"

He started to tell me that the company has been in dire straits for cash for years and that they had been using various acquisitions as a means of draining off cash from acquired companies for purposes of covering up their cash position.

So, I asked him about their financial statements and he told me that the financial statements, he said, were wrong. He said

that the financial statements, Mr. Goldblum would always require, as he would say, a certain earnings figure and then they would be inputing or putting through the computers certain numbers which would work out to the sales figures that the company wanted.

I asked a little further how that would be able to go with the auditors in verifying different things and he related to me how, for example, they would show sales of insurance policies by just having confirmations go out to various employees within the company and having the employees affirm back to the auditor that they do own these insurance policies.

I asked him why at this point in time did he feel that the acquisition in New Jersey of this life insurance [R. 7772] company may fall through.

He told me that he was afraid that the people who were negotiating on behalf of the insurance company in New York would find out exactly how poor or what's wrong with Equity Funding right then and there, that it is not as represented to them and they would back away from the deal. He felt it was very eminent for them to uncover the true status of Equity Funding.

We finished the conversation. It was quite an earth shaking conversation, to say the least, and I advised him that he should seek his own counsel. I advised him to go to the SEC and tell them everything he told them and following that conversation, I believe it was probably the following morning, because I remember it was late in the day when I spoke with him, I called Rudy Reinchild and I related the conversation to Rudy.

Q Now, I would just like to go over that conversation in a little more detail with you.

A Go ahead.

Q You are clear in your mind that Mr. Mercado told you that after Stanley Goldblum would set a certain earnings level, they would put the figures in the computer to come up with those earnings; is that correct?

A Yes.

Q You are clear in your mind that Mr. Mercado told [R. 7773] you that he was himself somehow involved in the accounting end of the business?

A He was concerned because he knew what was going on and he was in the accounting department.

Q You are clear in your mind that Mr. Mercado told you specifically that they would have these phoney policies and send out phoney confirmations; is that correct?

A That's correct.

Q And he told you this all in specific context with the then proposed Bankers National Life acquisition; is that correct?

A That's correct.

Q Can you remember anything else by way of details that Mr. Mercado told you in the conversation you had with him in your office that day?

A No. Unfortunately I didn't make any memorandum of it.

He was just being interviewed for a possible job with a client, which job he did not get.

JUDGE: What date was this?

THE WITNESS: This was late in 1971.

BY MR. BONDERMAN: Q You said the next morning you called up Rudy Reinchild and told him about this conversation?

A Right.

[R. 7774] Q Did you give him all the details you had at the time?

A I gave him everything I had at the time, right. Everything was fresh in my mind. I let it out on Rudy, let him have it.

* * *

Q Did you hear from anyone at the Commission after your conversation with Mr. Reinchild?

A Yes. Marty Robins called me on the telephone and he went over the facts as given to him by Rudy Reinchild as Rudy

got it from me and Marty did ask me if I knew of anybody who might be able to give him some testimony that worked for Equity Funding and I gave him the name of Mercado and I gave him the name of John Templeton, who was working for a client of ours.

Q I just want to be very clear.

Again, when you spoke to Mr. Robins, you told him specifically about phoney policies?

A Yes.

Q You told him specifically about phoney confirmations being sent to employees?

[R. 7775] A Right.

Q You told him specifically about the cash problems that the company had?

A Right.

Q You told him specifically about Mercado's fear with respect to the company folding if they did not acquire Bankers National?

A Right.

Q So you gave him and you discussed with him every detail you had gotten from Mr. Mercado?

A That's correct.

Q Do you recall approximately when that conversation was?

A Oh, I would say that the first conversation might have come, the first conversation with Marty, I spoke to Rudy Reinchild the following morning after I had met with Mercado, I would say that Marty called me within the week. I would say within a week's time, the first time.

Q Did you have a subsequent conversation with him?

A I had a second conversation with Marty Robins. It might have occurred several weeks thereafter. It might have been as long as a month, not longer than a month.

He did tell me that he struck out in trying to talk with Mercado and with Templeton and he asked me if I knew anybody else who might be able to give some information [R. 7776] or throw some information on the matter.

I told him I didn't know of anybody else.

* * *

Q When Mr. Robins told you he had struck out with Templeton and Mercado, did you understand what he meant?

A Yes. He said they would not talk to him.

* * *

EXCERPTS OF TESTIMONY OF WILLIAM MERCADO

[R. 8399] Q Was this December of 1971?

A That's correct. I was leaving Equity Funding and I was called in by Stanley Goldblum—no, as a matter of fact, it couldn't have been December—yes, it was either the latter part of December or the beginning of January, that's when it was and we were pretty much saying our good-bys [*sic*]. He wished me good fortune and just as I was ready to leave the office, he stopped me and he said to me, "It's very likely that the Securities & Exchange Commission will be calling you and that they would probably want to discuss things about the company.

They are prying into our business. I believe that there are several companies that are involved, companies and people, that are involved in circulating disparaging remarks about our firm and it could possibly be some kind of a play on the stock.

I would appreciate it if you used discretion and not discuss any of the affairs of this company with the SEC as, frankly, I feel that they have been poking their nose, so to speak, into our business more than they should."

[R. 8400] Q Did you have any comment that you made to him at that point?

A Yes. The comment I made to him at that point was, "Are you asking me to withhold information or to lie?"

He said, "No. I am simply asking you to use discretion in what you discuss with anybody, because the information that you have been exposed to or that you may know is company confidential and should not be discussed with anybody."

Q After Mr. Goldblum told you to expect a call from the Securities & Exchange Commission, did you get such a call?

A Yes, the next day. I got a call at about 10:00 o'clock in the morning from a gentleman by the name of Marty Robins.

Q What did Mr. Robins say to you in that conversation?

A That it was important that I meet with the SEC; that they were conducting an investigation into the affairs of Equity Funding and, as such, they had spoken to several ex-

employees and being that I had left the company, they would like to see me about it and a meeting was set up for the afternoon at 2:00 o'clock.

Q Did you go to that meeting?
A Yes, I did.

[R. 8401] Q Who was there?
A Marty Robins and his assistant, whose name I do not remember at this time.

Q And you were there.
Were you represented by counsel at that time?
A Well, what happened was the meeting time was set rather suddenly and I was attempting to reach my attorney named James Jess, who was unfortunately unavailable.
I believe he was at a trial and out of town.
JUDGE: For clarification, was Attorney James Jess the one you had talked to earlier?
THE WITNESS: Yes, sir.
JUDGE: And related your information?
THE WITNESS: Yes, sir.
JUDGE: Thank you.
THE WITNESS: So, in attempting—I was unsuccessful in attempting to reach him. So, I left a message with my wife to the effect that I was on my way to the SEC and that she should try and reach Jim, who was due back in his office, supposedly, sometime around 1:00 or 2:00 o'clock and that [*sic*] was going to the SEC to meet with a Marty Robins and if he would please join me there.
Subsequent to that, I left and I went for a meeting with the SEC.

[R. 8402] Q Did Mr. Jess join you there?
A No, he did not.

Q Did you later find out why he didn't join you?
A Yes.
After the meeting with the SEC, when I spoke with my attorney, he was furious at the fact that I had gone to the SEC without the benefit of counsel and, furthermore, he told me,

"Where were you?" And I told him I was at the SEC in some office and he said, "Well, I went there looking for you and I was told that they never heard of you and, furthermore, that there was no meeting going on as far as they were concerned."

BY MR. BONDERMAN:

Q Now turning back to the meeting which was going on at the time, how long did your meeting with Mr. Robins and his associates last?

A I really don't remember exactly, but it must have taken somewhere around two, two and a half hours, maybe more. I'm not sure.

Q During the course of that meeting, Mr. Mercado, did you tell Mr. Robins, as you had previously told Mr. Field, that you knew about this accounting plug?

A No, I did not.

Q Did you tell Mr. Robins, as you had previously told Mr. Field, that you had heard rumors to the effect of [R. 8403] fictitious insurance?

A No, I did not.

Q Why didn't you tell Mr. Robins that?

A Basically, after I had had that great meeting with Stanley Goldblum in which he told me that the SEC was going to be calling me next day, or when he told me the SEC was going to be calling me and the next day I got a call from Marty Robins, I felt I was being set up.

So, my policy there was to be as discreet and as cautious as possible and disclose as little information as possible, especially being that I was not represented by counsel.

Q In the course of that meeting, did Mr. Robins ask you point blank whether you had heard of fictitious insurance?

A I do not remember, but I don't believe so.

Q In the course of that meeting, did Mr. Robins ask you point blank whether you knew about falsification of earnings?

A If I might make a statement to clarify your line of questioning, counsel?

Q Certainly.

A The meeting, shall we say the basic spirit of the meeting was completely informal, and I was told that at the very beginning of the meeting that this was a [R. 8404] totally informal [*sic*], looking into the affairs of Equity Funding and that it was being done very discreetly and that it was being done on a totally informal basis as extreme caution had to be used in order not to precipitate some kind of problem for the company that could injure innocent stockholders.

So, there was no hard grilling or questioning in that sense. It was primarily questions of a general nature.

Q All right.

So, I take it that your answer is that he did not ask you point blank if you knew about inflation or the falsification of records?

A No, not that I can remember at this time.

Q Did you come to a second meeting with Mr. Robins with your counsel present?

A Yes.

After I had the meeting with Mr. Robins, I went to my attorney and I spoke to him about it and told him all the details about the meeting and he asked me specifically what I had said and I told him what I had said and he said, "Well, I'm glad at least you used some common sense in keeping your mouth shut."

He said, "The best thing for us to do now is to immediately contact the SEC again and have another [R. 8405] meeting with them right away, at which we will present to them that you have information material to the investigation of Equity Funding, but that you are not willing to disclose any of that information unless immunity is granted to you first."

Q Did you have such a meeting?

A Yes.

Q Who was present at that meeting?

A My attorney, Mr. Robins and his assistant, who I don't remember.

Q Do you remember what Mr. Jess said to Mr. Robins in the course of that meeting?

A Yes.

What he said to Mr. Robins was that Mr. Mercado had information that would be important and material to their investigation of the Equity Funding case, but that he had instructed his client not to say anything unless immunity was first granted.

Q Do you recall what Mr. Robins' response was?

A Yes. That the SEC was not in the business of giving immunity and that they could not even discuss it.

Furthermore, that if there was an issue of immunity involved, that we should contact the United States Attorney and discuss it with him.

Q Did he tell you anything about his continuing [R. 8406] interest in investigating Equity Funding?

A This is where my memory fails me a little bit, counsel.

That statement to the effect that the Equity Funding investigation was closed, the case was closed and there was no longer a need for any information, came in either at that meeting or at a subsequent meeting and I don't really recall, but that statement was made.

I believe it was on the second meeting, where Mr. Robins told my attorney that it was really not that important anyway and that—

Now I remember—wait a minute—I think there were a total of possibly three meetings.

There were two meetings one right after the other after I met with Mr. Robins. Then there was a meeting with my attorney and then there was a meeting which took place several months later possibly.

Q So you think that you had three meetings with Mr. Robins?

A Yes, possibly.

I wasn't involved in the first one, I don't think.

Q You think that your attorney met with him alone?

A Yes, right.

Q Let me just make it clear that it is your [R. 8407] understanding that a comment was made either in a second or a third meeting by Mr. Robins that there was no need for your information—

A It would have to be the second meeting, because I was there.

Q A comment was made at a meeting at which you were present by Mr. Robins that there was no need for your information because the investigation was not being pursued; is that correct?

A That's correct.

* * *

[R. 8451] Q Is it fair to say, Mr. Mercado, that the substantive matters about Equity Funding, which we have discussed at the Robins' meeting, were 180 degrees different from what you had discussed with Mr. Field a [R. 8452] month before?

THE WITNESS: I think it's fair to say that I did not volunteer any information or come out with any statements regarding what was going on at that time, because what had been presented to me as a very informal hearing, all of a sudden started to look very menacing and I knew that I was treading on thin ice.

* * *

EXCERPTS OF TESTIMONY OF STANLEY GOLDBLUM

[R. 8524] Q * * * What was your perception of Mr. Dirks at that time as to whether or not he was convinced of the truthfulness or accuracy of the information that was derogatory about Equity Funding?

A I had the impression that he was very much convinced that the information he had was correct.

* * *

[R. 8548] Q You were asked a question concerning the calls you were getting from brokers and you said towards the end you were getting as many as ten calls a day from brokers.

Were those calls relating to the volume and price action in the stock?

A Yes.

Q Were those calls relating to details and specifics of the story that Mr. Dirks had related to you or that you knew about?

[R. 8549] A No.

Many people called who asked me what was happening. They had not heard the rumors but wanted to know what, if anything, was the reason for the price action and the volume.

* * *

[R. 8571] Q In your cross-examination, Mr. Goldbloom [*sic*], at one point you made a point to the effect that had Mr. Dirks been wide of the mark with the elements of investigation "We wouldn't be here today." Explain what you meant by that, please.

A If he would have been wrong, there would have been no fraudulent reinsurance, et cetera, and there would have been no following events that took place since then. That's what I had in mind.

Q Do you hold Mr. Dirks personally responsible for [R. 8572] having uncovered the events at Equity Funding which you were denying during those weeks?

A I think Mr. Dirks is entitled to personal credit for that.

* * *

[R. 8574] Q The entire period preceding March, 1973 during which fictitious insurance had been on the books of EFLIC, were you ever approached in any serious manner by any auditor of the parent or subsidiary with information which would have led to the uncovery of the fraud?

A I don't know what you mean by any serious way.

Q Did any auditor for the parent or subsidiary ask you any questions which suggested to you that they suspected there was a fraud at Equity Funding?

[R. 8575] A No.

Q Did any person from any Federal regulatory body as [*sic*] you any questions which led you to believe that they were suspicious of fraud at Equity Funding?

MR. MALAWSKY: Could you put a time on that?

BY MR. BONDERMAN:

Q Prior to March, 1973, I am sorry.

A No.

Q Prior to March, 1973 did any employee or agent of any State regulatory body ask you any questions which would lead you to believe that they suspected there was fraud at Equity Funding?

A No.

Q Is it your belief, Mr. Goldbloom [*sic*], that in the absence of Mr. Dirks spreading these rumors in March of 1973 the fraud would have gone uncovered?

A Ask me that again.

Is it your belief that had these rumors or the allegations not come to Mr. Dirks' attention in March of 1973 that the fraud would have gone uncovered at Equity Funding Corporation of America?

A It's a very hard question to answer. I can conceive of a set of circumstances where the answer is yes.

Q What are those circumstances?

A Where the people who brought the information to Mr. [R. 8576] Dirks in fact themselves discontinued doing so and

were [*sic*] the then employees of the company continued to perform the functions they were performing in the way they were performing them and that no other investigative body would attempt to uncover the false information. I guess under those circumstances it would have continued for a while.

Q In fact, wasn't it your belief in 1973 that if you had another year or two you would get all this phoney insurance off the books?

A Yes.

Q In which case as far as you were concerned this fraud might not have been discovered; is that correct?

A It was my belief that given a period of time in the order of two years or so that we would have corrected the problems in such a way that the fraud would not have been discovered.

Q Do you hold any animosity or bitterness against Mr. Dirks for the fact that he precipitated the events which led to the discovery of the fraud?

A Not now.

Q Do you remember Mr. Simonds making a comment to you this morning before this proceeding commenced that Mr. Dirks was really swimming against the tide at that point?

A I heard him say that.

Q What did you say in response?

[R. 8577] A I hoped he drowned.

* * *

EXCERPTS OF TESTIMONY OF WILLIAM BLUNDELL

[R. 8679] Q Did there come a time sometime in March of 1973 when you heard there were rumors floating around about Equity Funding Corporation of America?

A Yes.

Q How did you first find out about those rumors?

A I first found out about them from an opposite number.

Herb Lawson called me and said he had been contacted by Dirks and Dirks had told him about certain things that purportedly were happening at Equity Funding Corporation.

And he told me that Dirks was going to be in Los Angeles the next day or arriving that night.

"I want you to get in touch with him."

Q Did Mr. Lawson tell you the nature of the allegations?

A In a very general way.

Something about phony insurance, this sort of thing.

[R. 8680] I don't remember the specific allegation.

Q Can you remember the type of detail he provided?

Specifically, did he tell you that there were allegations of phony policies on the books?

A Yes.

Q Did he tell you that there were allegations of reinsurance of these phony policies?

A I don't recall.

I don't believe so.

Q Do you recall if he told you there were allegations of other kinds of fake assets or nonexistent assets?

A In a general way, he may have.

Q Do you recall whether he told you that there were allegations that the officers of the company were about to flee the country?

A I don't remember that.

Q With substantial assets?

A I don't remember.

Q Do you remember anything else that he told you?
A No.
It was a very brief conversation.

Q What was your reaction when you were informed of these allegations in a general way by Mr. Lawson?
A It was just another rumor and we get rumors all [R. 8681] the time.
Some we can get checked out if they are promising.
Others where we can't get a handle where the information is so vague and so general or the source won't talk to us personally, we usually forget it.

Q When you say you get rumors all the time, do you get rumors of fraud at substantial companies on a frequent basis?
A Well, I couldn't say rumors of fraud in substantial companies on a frequent basis, but we do get allegations of fraud and all sorts of companies, most of them anonymous, most of them with information that is simply unavailable.
They will say "look into so and so," as if we could march in there and throw the chief executive against the wall and ring the truth out of him.
Most of them have to be left out because they are a waste of time to pursue.

Q After you got the call from Mr. Lawson, what did you decide to do with respect to the rumors he told you about?
A I decided to talk to Dirks and called him at the hotel and made an appointment to meet him.

Q Did you have any conversation with Mr. Dirks at that time beyond setting up the appointment?
[R. 8682] A Not that I recall, not anything significant.

Q Did you meet with Mr. Dirks?
A Yes.

Q Do you recall when that was?
A It was the day following, I believe, at around 3:30 at the Beverly Wilshire Hotel.

Q Can you recall what day that was?
A The 21st.

Q Of March?
A Yes.
It would be somewhere around the middle of March—in March.

Q Let me state that there is a calendar for you to look at.
There is testimony in the record from Mr. Dirks that his meeting with you was on the 21st and I take it that is consistent with your recollection.
A That is consistent with my recollection.

Q Do you recall how long the meeting with Mr. Dirks took?
A Two and a half hours, somewhere in there.

Q Do you remember precisely where the meeting took place?
A It took place in the Hideaway Bar, a cozy, little nook in the Beverly Wilshire.

[R. 8683] Q Can you remember what was said during the course of the meeting?
A A great many things were said.
Ray outlined for me the allegations that he had heard supposedly from people who used to work for Equity Funding and some were still employed by Equity Funding. They had to do with the manufacture of phony policies which were supposedly resold to gullible reinsurance companies at a very large profit to Equity Funding.
We talked about the forgery of the policy files, if I recall.
I can't remember if we got into the death claims issue or not.
We talked about the possibility that their earnings might have been skewed and the earnings of the insurance company particularly being pulled out of thin air.

Q You mean EFLIC?
A Yes. The main subsidiary.

Q Did Mr. Dirks have any notes with him?

A I have never seen Mr. Dirks without notes. Mr. Dirks had a full briefcase all the time.

A large part of our conversation had to do with educating me somewhat in reinsurance and why they did it and so forth.

[R. 8684] Q During the course of this conversation, was it your impression that Mr. Dirks was going through his notes and repeating to you information which was contained in those notes?

A At times.

I think most of the papers were such a jumble that I couldn't say that with a certainty. It was not a question of his saying, "And then so-and-so told me" and consulting his notes.

That may have happened a couple of times, but mainly it was a general, face-to-face conversation.

Q Do you recall that he specifically told you about the allegations of phony insurance policies?

A Yes.

Q Do you recall he specifically told you that there were allegations that there were phony policies being reinsured?

A Yes.

Q You cannot recall whether he told you at that time or at a later time about phony claims or death benefits?

A He may have.

That would be consistent with my recollection.

Q What about allegations of missing assets?

A I don't remember any allegations of missing [R.8685] assets.

I do recall general conversation on how the books might have been skewed.

You say "missing assets."

I think it was more a case of overstating assets that they did have and understating their liabilities.

Q Did Mr. Dirks give you the names of persons who had furnished him information?

A He gave me the names of probably everyone who worked for the company at any time and he mentioned several people and recommended that I talk to them, which I did.

Q Did he give you the name of Ron Secrist?
A No, because I had gotten that from Herb Lawson before.

Q You already had that name before you met Mr. Dirks?
A Yes.

Q Did he give you the name of Mr. Frank Majeurus?
A I would rather not go into the names that he gave me. I can tell you that I talked to a number of people that he recommended I talk to, and I talked to other people as well.

Q Well, let me state, Mr. Blundell, I appreciate [R.8686] your interest in protecting your sources.
On the other hand, Mr. Dirks is my client and I don't believe that what he told you is protective in any way.
I don't intend to ask you any questions as to who you talked to based on the information.
A I can tell you that on that list which included then practically everybody in the official persons who worked for the company that Frank Majeurus' name did appear.

Q Did he indicate specifically which of these people on the list had given him information?
A He didn't give a full recounting of who he had gotten the information from, but he mentioned several names in the course of things.
"So and so said this. He told me that," and so forth.

Q Did he tell you in the course of this information that he thought you ought to talk to certain particular people as opposed to the entire list?
A Yes, indeed, he did.

Q Was there any conversation in the course of this meeting between you and Mr. Dirks as to the possibility of or credibility of the likelihood of these rumors being true?

[R. 8687] A There was a great deal of that discussion because both of us had certain problems with the information and one of the principal problems was the difficulty of the auditors.

There had been at various times—this was a fraud that was supposed to have involved both the parent company and the largest insurance subsidiary. Various times there had been three auditing concerns—two of them had been Big 8's—that worked on the insurance company and I guess the parent was always Seidman & Seidman, but the insurance company where the fraud supposedly centered in the manufacture of policies had been handled by Haskins & Sells as well as Seidman & Seidman and I think before that by somebody else, and the stuff had never been detected.

If it existed in the scale which supposedly it existed in, neither one of us could see how any auditor worth a dam could have missed it.

That was the unsurmountable problem we had.

Q Basically because of the fact that the auditors had given clean reports you had difficulty comprehending that this could possibly be true; is that correct?

A Not because basically the auditors didn't give a clean report, but because of the reported scope of the fraud I did not see how it could have been missed by an [R.8688] honest auditor and we made the assumption that the auditors were honest.

Q From that you didn't see how it could be true; is that correct?

A That's correct.

Q Was there anything else in the nature of the purported scheme that caused you to question the believability or likelihood?

A Yes.

There was a problem with the reinsurance, how the reinsurers could miss all of these policies that were being sold to them as being bogus and how the company which had a liability for

the payments of premium in the years after the initial sale of the policy and the premium—90 percent of it would go to the reinsurer—we could not understand if there was this much phony business on the books, how Equity Funding could possibly keep up with the cash needs that would have to flow to the reinsurers.

Of course, they were keeping up in a geometric way.

The thing was an inverted pyramid.

The more phony business you sold to others, the greater your liability the next year, meaning you would have to sell twice as much phony business.

[R. 8689] We saw that this could happen, that the sales could happen, but we didn't see that it made any sense for the company.

The company was digging itself in a hole that they could never get out of.

Q That also led you to conclude it was not likely to be true.

Is that also correct?

A Yes.

Q I take it that at the culmination of this meeting with Mr. Dirks it was your impression that the story was not likely to be true; is that correct?

A Yes.

It was my impression that the story in its full scope was not likely to be true.

Q Did Mr. Dirks in the course of the conversation tell you that he thought these allegations were likely to be true?

A I think he was undecided.

I can't remember clearly.

He was certainly—he certainly didn't come all the way out to Los Angeles if he felt that the story was completely phony.

On the other hand, he could see the difficulties involved in it, and I think—or the feeling the both of us [R.8690] had was:

"We have all these people telling us it happened, but it doesn't make any sense."

I think the feeling was one of puzzlement rather than complete disbelief.

Q Would it be fair to say that he shared your views as to the auditor problems?

A Yes.

I think that's fair to say.

Q Would it be fair to say that he shared your views as to the practical difficulties that this would cause the company? An inability to see where it could benefit the company?

A I think that is fair, yes.

Q I take it that Mr. Dirks did not say to you at any time during the course of this meeting that he thought this was true?

A I simply can't recall any flat statement of that regard.

Q Did you take any notes during the course of your meeting with Mr. Dirks?

A Very few because Mr. Dirks was not a source for me. He was a tipster and that is different from being a source for any story I might do.

[R.8691] Q Tell us what you mean by "source."

A To me, in a story of this nature a source would be someone who actually did, saw, or heard here the things that would be useful to me in my story.

Ray had nothing to do with the Equity Funding fraud and he never saw anything happen in Equity Funding and everything that he heard was secondhand, and consequently, as far as I am concerned, inadmissible.

Helpful but inadmissible.

Q I take it after speaking to Mr. Dirks you didn't feel that you had any particular evidence of fraud at Equity Funding?

A None whatsoever.

What I had was a security analyst telling me that other people told him that there was fraud at Equity Funding.

Q Let me ask you this:

After you had heard the story, did you have any alternative explanations for how this story might be around besides the fact that it could possibly be true?

A If you want to be super-skeptical about it and we really have to be, there is a possibility of a combine, of people who where short on the stock.

The stock had been very volatile. It had been going down very sharply. That possibility existed.

[R.8692] Another possibility that Dirks or his clients had certain interests in the stock and interests that I would not necessarily know about and that he wouldn't tell me about.

I did not know Dirks.

And the other possibility is that part of the story might have been true.

There's minor hanky-panky here and there. There might be fenceposting of some phony policies, but not that many, but there might be petty embezzlement but not that much, but the story would not nearly be as big a story as we were led to believe.

Q Mr. Dirks told you and I take it Mr. Lawson that these allegations had originally come from Mr. Secrist?

A That's correct.

Q Did you think of any motive of Mr. Secrist to spread allegations like this if they weren't true?

A We frequently get—yes.

The motive might be revenge.

We frequently get complaints and tips from people who have been discharged by these companies for one reason or another:

A grudge against them and they want to make trouble for them. This might have been the case with [R.8693] Secrist.

I did not at first know that he had been discharged by the company. He only said that he left the company and he left me with the impression that he left in some sort of moral outrage.

I did not know that he had been fired or laid off.

Q When you found out he had been fired, did that impression change?

A Yes.

It led me to doubt his motive and along with his motive, credibility.

Q When is the first time you spoke with Mr. Secrist?

A I don't remember.

I think I spoke to Secrist perhaps either right before I spoke to Dirks or right after.

I had two conversations with Secrist, one at the beginning of this investigation job and the other at the end.

Q All right.

Did Mr. Secrist tell you anything in the first conversation that Mr. Dirks did not tell you in your meeting with him?

A Not that I recall.

[R.8694] I simply wanted to hear the general allegations from Secrist himself since he had been an employee of the company.

Q Let me ask you this question again:

Do you recall whether you had heard general allegations from Mr. Dirks before you talked to Mr. Secrist?

A I do not recall because I don't know the time frame as to exactly when I talked to Secrist.

Secrist and Dirks were very close together, but I can't say who came first on the first conversation.

Q Did you have any notions of publishing a story on these allegations after the 21st or publishing at that time?

A Publishing, detailing these allegations?

Q Yes.

A No.

Q Why not?

A First of all, they were flat-out rumors. I had not proved anything.

The information that I had from Dirks was as I pointed out unusable.

If I had gone ahead and given the nature of those allegations without any proof, it could be extremely damaging to the company and its stockholders and bondholders.

[R. 8695] Q And so I take it you are not inclined to do something like that?

A No, I am not.

Q Did Mr. Dirks mention to you in the course of your meeting on the 21st that he had met Mr. Goldblum and other high executives of the company who had denied all these allegations?

A He said he did, yes.

I believe that he did, yes.

Q Did you have any feeling on or about the 21st after you talked to Dirks that either you or he should go to the SEC with the allegations or information?

A I had no feeling that either one of us should go.

I can't answer for Ray. He does what he wants to do.

My own feeling is that I had nothing that would have been of interest to the SEC outside of a rumor.

Q Now, why is that?

Explain your answer in a little more detail.

A We frequently get information from people and the last thing that I would do would be to run to the SEC with just wildhair rumors about things that are supposedly going on without any real lead for them to follow [R. 8696] or any indication on my part that there might be some truth in them.

There was absolutely no support for the allegations. Until there was some support and until I felt convinced that there might indeed be some truth, not the whole story, but something of the truth firsthand, then I wouldn't go to them.

I might not go to them anyway, I ought to add, because we do not work hand in glove with the SEC.

We cooperate with them in certain matters but if I have got a story then, and I can get the whole thing and get it out, I am not going to go to the SEC.

Q With regard to appropriate occasions from time to time you have gone to the SEC as you did in this case ultimately?

A Yes.

Q I take it you have had some experience in working with the SEC even though you didn't feel obligated?

A Yes.

We would commonly work with the SEC on various matters.

Q Mr. Blundell, do you remember being deposed in a deposition at 9:30 a.m. on February 24, 1976?

A Yes.

[R. 8697] Q I'd like to refer you to pages 73 and 74 of that deposition.

The question starts on line 27, page 73, and your answer which runs over through line 16.

Would you read that and let me ask you if that answer is true and correct to the question?

A That's correct.

Q I am going to read the question, and would you read your answer that you gave under oath at that time?

"I now direct your attention solely to the conversation of March 21, 1973. Did you form any conclusion as to whether or not that information should be conveyed to the SEC at that time?"

A "My conclusion, basic conclusion, was that, no, it shouldn't. The SEC has much the same problem that we do in the sense that they get a lot of over-the-transom stuff and they need something to chew on. They need some people to talk to. The more sources they have the better and the more credible sources they have the better. To me, Ray Dirks was no source at all. He was just, you know, a little guy off the street dealing in hearsay [R. 8698] and Secrist I knew nothing about. We knew he had left the company under circumstances that turned out were not the best. Consequently, it might be just another source of a guy—and the SEC gets these all the time—who feels he has been shafted and wants to make trouble."

Q I take it that is consistent with your present view?

A Yes.

Q Now, after you spoke with Mr. Dirks and met with him on the 21st, did you decide to go ahead and investigate the story yourself?

A Yes, I did.

Q And did you do that?
A Yes, I did.

Q How long did your investigation last?
A Probably 10 days.

Q Can you tell us from your recollection, when was the first time that you felt comfortable publishing a story detailing what you thought was going on at Equity Funding?
A Publishing a story that would say unequivocally what I felt was going on at Equity Funding?

Q Yes.
[R.8699] A That would be on Friday evening which would be March 30.

Q When was the first time you felt comfortable publishing any story with respect to rumors or what was alleged to be going on at Equity Funding?
A That is harder to explain because there was news being generated during this period by events that I had nothing to do with.

When an event happens—a press release by a company or something significant—it is taken out of my hands unless I think the matter is so trivial and so self-serving that it is not worth covering.

Once I decide the matter that the company is bringing up is worth covering, then I have to do something about it.

I want to make that distinction.

The main feature story on April 2nd was my own volition when I had decided.

The other coverage arose from things that happened outside of my control, namely, the company making a statement about the rumors, that sort of thing. In that case I definitely would print something, and we did.

Q All right.
We will get back to that in some detail, but let me ask you this:

[R. 8700] Did you speak to anyone in the course of your investigation on the next day, the 22nd?

A I don't remember.

I very well may have.

Q Did you speak to anyone in the course of your investigation on the 23rd?

A I spoke to some people most every day right up until the time we published.

* * *

[R. 8701] Q Did you meet with Mr. Dirks and two other people at one time?

You had a third conversation with Mr. Dirks where he told you about the notes and you had, I believe, a fourth conversation where he asked if you were ready to do anything?

A There might have been more a single inquiry on his part as to whether I was able to to anything.

I remember once or twice. That's the best of my recollection.

There was no information passing between us at that time.

It was just a touching-base sort of thing.

Q With respect to these inquiries from Mr. Dirks as to whether you are ready to do anything, is that to say that Mr. Dirks was asking you to print a story on the [R. 8702] subject?

A I believe my recollection is that was his interest.

He wanted to know if I had enough to print the story.

Q So it was your understanding that Mr. Dirks was interested in having you print the story on this subject?

A That was my understanding.

Q When did you first become convinced that the story was true?

A I became convinced that the story was true after talking to a couple of people—or at least key parts of it were true—after talking to a couple of people at Equity Funding who admitted to me that they had engaged in various criminal action and who emotionally broke down about this thing.

This is very credible type information.

Q Now, do you recall when that was?

Can you give us a time frame of this period that we are talking about?

A That would be early—it would be between the 21st and the 26th.

Q Was it before you called Mr. Sporkin?

A I cannot remember.

[R. 8703] Q Did you at one time decide that that matter should be brought to the attention of the SEC?

A Yes, I did.

Q Do you recall when that was?

A Within a couple of days at—after talking to Mr. Dirks I talked to several people myself and asked them what they had done, seen, and heard; and the answers were sufficiently alarming to me so that I felt the SEC ought to know about what the information was with an eye towards stopping trading in the stock.

Q Do you recall when that was that you reached this conclusion?

A Around the 22nd or the 23rd.

Shortly—very quickly after I talked to the first few people.

Q What did you do after reaching that conclusion?

A I called up Jerry Boltz who was the Regional Director of the SEC.

Jerry was quite ill and I called up Stanley Sporkin who was the head of the Enforcement Division of the SEC.

Q Did Mr. Boltz suggest that you call Mr. Sporkin?

A I do not remember.

Someone else may have.

Q Did you speak to Ralph Erickson when Mr. Boltz [R. 8704] was out?

A I may well have spoken to Ralph, yes.

Q You called Mr. Sporkin in Washington?

A Yes, I did.

Q Do you remember what you told him?

JUDGE: What date was that?

THE WITNESS: I cannot remember the exact date. It probably would be the 23rd.

And I called Mr. Sporkin in Washington and no one has protracted conversations with Mr. Sporkin. If this young lady has trouble with me, she should have Stanley Sporkin on the stand.

Anyway, he very quickly decided to look into it.

I told him I had talked to several people who had told me that earnings were being manufactured at the main insurance subsidiary of Equity Funding, who told me that they had engaged in—I believe we were in the policy file forgery at this time and that a certain amount of business was being resold to reinsurers that did not exist.

BY MR. BONDERMAN: Q At the time you talked to Mr. Sporkin, did you have any idea of the scale of what was going on at Equity Funding?

A I knew what the scale was purported to be just by [R. 8705] rumors.

Once again, no one absolutely knew.

Q Did you have any conviction yourself as to what the size of this fraud was likely to be?

A I had no conviction or knowledge at that time.

I knew it seemed to me significant.

Q You have told us what you told Mr. Sporkin.

What did Mr. Sporkin say to you, if you recall?

A Mr. Sporkin said something to the effect that they were going to get on it right then and sure enough that's what they did.

Q Did you have a phone call from someone at the SEC or did you call them again?

What was your next contact with the SEC?

A The next contact I think was initiated by the SEC and we had a meeting.

Several people from the Los Angeles office of the SEC came to my office.

Q Do you know when that was?
A It was probably the following Monday, which would be the 26th.

Q Do you remember what time of day it was?
A I do not remember.

Q Do you remember who came to your office?
[R. 8706] A Well, I know Les Ogg from the SEC was there. I believe Jerry Boltz was there. I believe Ralph Erickson was there.

Q Do you recall anyone else?
A No, I do not.

Q Do you recall anyone from the Wall Street Journal besides yourself that was there?
A I do not recall.

Q Can you tell us what was said in the course of that meeting?
A In the course of that meeting I told them without disclosing the source of my information that I had talked to people who had told me—led me to believe, anyway, that something really terrible was going on over there, mainly the resale of policies to reinsurers, policies that did not exist, the creation of phantom business, the manufacture of earnings. Those were, I guess, the two principal things.

I cannot remember whether we got into the death claims issue or not.

Q After you had given this information to the people at the meeting, what was the response?
A The response was that we begin mutually to examine this information.

I did not present this information as gospel. I [R. 8707] do recall that it seemed to me that the people who told me were very credible sources and this was the reason I called them and they began to—we began mutually to examine the problems

and the auditors' problem came up, the problem of the terrible geometry of this whole scheme as far as rebounding on the company within a very short period of time, which we couldn't figure out: how anybody in the underwriting or insurance business would try to undertake such a mad scheme that commonsense would tell him would have to collapse around their ears in a very short time. We could not understand. We didn't get over these hurdles.

Q Who was asking questions from the SEC delegation?

A I believe all of them were asking questions or most of them at one time or another.

Q Did Mr. Ogg play a particular role in that meeting?

A Yes.

Les Ogg was along because he supposedly knew a good deal about insurance companies.

At least, this is my recollection of someone, Les, being there; because he knew about insurance companies.

He asked I think the most penetrating questions [R. 8708] having to do with the geometric nature of the fraud and the problems involved, why would anyone do this, and stuff like this.

Q Did you have the impression based upon Mr. Ogg's questioning that he was skeptical of the likelihood of this massive fraud being true?

A I can't get into his head and say that he was or wasn't, but I think he was skeptical.

My impression was that he was skeptical that anything of this scale could have happened.

Q That was for the same reasons that you expressed previously that you were skeptical?

Specifically, you had the auditors' problem; is that correct?

A Yes.

I think he stressed the nature of the reinsurance business and the obligations of the company that sells policies.

My own feeling was the auditors, but together we sort of bumped into these two problems and we were chewing on them

and really came to no resolution as I recall as to how it could have reasonably happened.

Q I take it that at the time you had the meeting with the SEC, though you had talked to a number of people who did not regard yourself in the position of publishing [R. 8709] the story as to what was going on at Equity Funding?

A No, I did not.

* * *

[R. 8738] Q Mr. Blundell, I'd like to ask you a few more questions.

Is it fair to say that when you first heard the allegations from Mr. Dirks in the meeting of the 21st, you thought they were quote "laughable" unquote?

A Yes. When I say "laughable" in a double sense. I thought they were unbelievable and I also thought if there was any germ of truth, it would be the greatest piece of chutzpah in American corporate history.

Q Did you also have a notion when you heard this quote unquote sounded terribly unlikely?

A Yes.

Q Was it also the case that Mr. Dirks agreed with the quote unquote sounded terribly unlikely?

A I think he was—he obviously thought enough of what he was hearing to come out here. He obviously put belief in what some people were telling him but, yes, I do agree that both of us had certain problems in believing that the whole thing could be true.

Q In your view as an experienced journalist, would [R. 8739] any reputable journalist published [*sic*] a story of the sort that you ultimately had published on April 2nd before that date?

A Well, no one that I call responsible based on the information that I had because I was getting—right through Saturday it was really a very short time to develop a story like that—at least for us.

Q With respect to your publishing an article, isn't it fair to say that Mr. Dirks made it clear to you that he wanted to publish the story as quickly as possible?

A I think we did want—he wanted to see something in print.

I think he expressed several times about the trading halt and this sort of thing.

* * *

[R. 8746] Q In this connection did he make any mention of trying to check out the feasibility of the alleged scheme with his clients?

A That I don't remember. I frankly don't think his clients could have told him much about it, because I don't think they were—they were portfolio managers who didn't know beans about insurance operations.

I don't see how they could have known and I don't recall him saying that to me.

Q Did Mr. Dirks ever indicate to you why he was spending a good bit of his time and I guess some money investigating this whole Equity Funding matter?

[R. 8747] A The impression that I thought was twofold.

Q First, did he ever tell you why he was doing it in so many words?

A In so many words I can't remember him saying "Here's why I am doing it." The best I can do after these years is a recollection he was naturally inquisitive.

He's a very inquisitive person. I think he became intrigued the further he got into this thing and, secondly, he had some very important clients with a lot of stock.

Q Let me be clear in connection with the latter part of your answer. Was there anything he said or did that led you to believe that he was acting out of a motice [*sic*] to inform his clients?

A Yes. I believe that that was definitely part of his motivation.

I believe his action in coming out here and staying in frequent touch with them definitely indicated to me that one reason he was here was to find out what was going on for the benefit of his clients.

* * *

EXCERPTS OF TESTIMONY OF WILLIAM MALONEY

[R. 9954] WILLIAM MALONEY,

* * *

[R. 9955] Q What is your occupation, sir?
A Investment manager.

Q By whom are you employed?
A Institutional Capital Corporation, Chicago.

* * *

Q What is your position with Institutional Capital?
A President.

* * *

[R. 9973] Q Confining ourselves now to this conversation of the 19th.
A Right, yes.

Q Okay.
A * * * I also asked him how many people he had told this to.

I think he told me I was the second or third person.

I said, you know, these are pretty serious charges—pretty serious allegations you are bringing and could have serious effects.

I said, does your firm know that you are promulgating this stuff.

He told me they did.

I asked him if—if it was that serious why he didn't go to the stock exchange of [*sic*] the insurance commissioners or the SEC with it because it would mean an awful lot of it [*sic*] were true.

It would be disastrous obviously.

If it wasn't true he'd have tremendous volatility in the stock.

[R. 9974] And I said, Ray, you have a good reputation for being a competent analyst.

I said, I think it is to your advantage to protect that reputation.

I said I think this may be inside—inside information and you better check it out.

I asked him if he had confronted Goldblum with this information.

He said he had not and that he was planning to go out there in a couple of weeks.

I guess he gave me a date, the 27th of March or something, the 28th.

I told him I didn't think that was good enough, we owned the security.

But I thought that he ought to get on an airplane and go out and confront Stanley Goldblum with all these things and call me back.

And since I wanted him to go I said, if you go I will pay your expenses out there.

So Ray went out there.

* * *

[R. 9981] Q I think you testified that you asked Mr. Dirks why he had not reported this or if he had reported it to the SEC—

A Right.

Q —or the stock exchange or the insurance regulators?

A Yes.

Q Did he reply to that?

A I never got a satisfactory—satisfactory answer as far as I was concerned from Mr. Dirks on that subject.

Q Did Mr. Dirks express any feeling of his regarding the SEC or the stock exchange to you?

[R. 9982] A I cannot recall.

Q Did you have any discussion with Mr. Dirks regrrding [*sic*] the possible effect on the market for Equity Funding securities?

A Oh, yes, I mentioned that in my earlier testimony.

If it were true, obviously it was a disaster.

If it weren't true you could have a sudden drop and I remember telling Ray that the situation was bigger than my clients holding and his good reputation.

There were a lot of little people that owned this security and if it had a precipitous drop they could go out of the bottom and it could come back again.

And I thought he had a great professional responsibility to conduct himself properly, to avoid this type of situation happening.

Q Did you specifically discuss with him what possible effect would be [*sic*] if larger institutional sellers started liquidating their holdings in Equity Funding?

A No.

MR. SIMONDS: Objection.

A No.

MR. SIMONDS: I will withdraw it but I prefer we don't have [*sic*] leading questions that attempt to put in [R. 9983] this witness' mind conversation he can't otherwise recall.

JUDGE MARKUN: I will admonish counsel to avoid leading.

MR. KARLEN: Thank you, your Honor.

Q You testified that you raised the possibility with Mr. Dirks that this might be inside information?

A Yes.

Q Can you elaborate any further on that portion of the discussion?

A Well, when I said it may be inside information Ray said how can it be inside information, they are former employees.

I said, yes, but they know something presumably the investing public doesn't know.

And I reminded him of the case of the lums [*sic*] and the Bausch & Lomb case and the nebulousness of the rule regard-

ing inside information and thought that there again he might be injuring a good professional record.

And I made the point several times over that I don't buy stocks on this kind of information. I certainly don't sell them on that kind of information.

Q What did you tell Mr. Dirks about the Bausch & Lomb and Lums case?

A Well, I think I just told him that Wally [R. 9984] McCullum from Falkner, I believe Falkner Dawkins & Sullivan, went out there, got some information and he came back and thought he was doing a good analytical job and published it and there was quite a bit of repercussion.

And at the Lums case I guess that was up in IDS where they presumably had some inside information and took—acted on it and there was a lot of trouble and litigation.

And I thought that Ray being the professional that he is that he ought to consider that.

Q Did you suggest that Mr. Dirks take any action?

A Yes.

I suggested that—as I have testified, I suggested that he go out to California, confront Stanley as soon as possible, that day, call me as soon as he got out there and let me know what was going on.

* * *

EXCERPTS OF TESTIMONY OF DONALD KRAMER

[R.10,500] DONALD KRAMER.

[R.10,501] Q Directing your attention, Mr. Kramer, to the month of March of 1973.

A Yes.

Q Where were you employed at that time?

A I was a general partner of Oppenheimer & Company.

Q And could you describe what your duties and responsibilities were at that time?

A Yes.

I was in the research department. I was a research analyst specializing in insurance stocks.

I also served the corporate finance department and some managerial responsibility in research.

Q As an analyst, did there come a time when you became interested in the securities of Equity Funding Corporation of America?

A Yes, I did.

[R.10,502] Q When was that, sir?

A Somewhere in 1970 or '71.

* * *

[R.10,540] Q Mr. Kramer, prior to March 27th, 1973, did you know or had you heard that Equity Funding issued and was carrying on its books and records false or fictitious insurance policies?

A No.

Q Did you know or had you heard that Equity Funding had co-insured or reinsured fictitious insurance policies?

A No.

Q In March of 1973, Mr. Kramer, were you familiar with the terms co-insurance?

A Yes, I was.

Q Were you familiar with those terms as Equity Funding applied them?

A Very much so.

Q How would you become familiar with them?

A Well, Equity Funding, in order to finance its rapid growth, was forced, I thought, to co-insure [R. 10,541] large portions of its business.

By so doing, essentially they were selling future profits for current dollars, current income.

And since an analyst is concerned with the durability and persistency of a company's growth, the sale of its future profits now made it somewhat less attractive than it might have been if they were able to keep that business on their books.

And so I spent a fair amount of time getting involved in analysis and understanding of their co-insurance.

They supplied me with something called a co-insurance white paper and they also looked at some of their—the terms and conditions of their co-insurance agreement to see how they operated and spent a fair amount of time with management learning how I thought these things operated.

Q Based on your analysis, Mr. Kramer, did you form an opinion as to the propriety of Equity Funding's co-insurance operation?

A I thought they were bon [*sic*] fide sales.

Q Prior to March 27, 1973, did you know or had you heard that Equity Funding had fraudulent books and records to support fictitious policies in co-insurance?

A No, I don't remember hearing anything of that kind.

[R.10,542] Q Prior to March 27, 1973, had you heard that Equity Funding had issued fake and fraudulent financial statements in order to support fictitious policies and co-insurance?

A Not with regard to fictitious policies or co-insurance.

Q Prior to March 27, 1973, did you know or had you heard that top officers and directors of Equity Funding were

involved in any of the activities that I have just described in my previous questions to you?

A No.

Q So that the record will be clear, Mr. Kramer, did you hear any of the things that I have just mentioned in my previous questions on March 27th as opposed to prior to?

A No.

Q On or prior to March 27, 1973, Mr. Kramer, had you heard anything that led you to believe that there was fraud at Equity Funding?

A No.

Q Did there come a time when you learned that there was fraud at Equity Funding?

A Yes, obviously.

* * *

EXCERPT OF DIVISION EXHIBIT 17

DIRKS BROTHERS
7 Dey Street
New York, New York 10007
Tel. (212) 349-5700

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February 15, 1972

INSURANCE CONFIDENTIAL

Ideas on Insurance Stocks

By Raymond L. Dirks

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* * *

DIVISION EXHIBIT 24

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ADDRESS:

REP: Ray Dirks

AMOUNT: 4,000 - 5,000

REASON: Insurance Co. reports & recommendations

3-15-73 $3,956.20

REQUESTED BY: /s/

APPROVED BY: /s/

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Mar. 15 10:15 AM '73

T-904 6/72

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SEC. EXCH. COMM.
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☒ Moran ☐ ____
☒ Malawsky ☐ ____
☐ Jacob ☐ ____

United States Department of Justice

UNITED STATES ATTORNEY

CENTRAL DISTRICT OF CALIFORNIA
U.S. COURT HOUSE
312 NO. SPRING STREET
LOS ANGELES, CALIFORNIA 90012

May 21, 1976

Mr. Roger Deitz
Special Counsel
Securities & Exchange Commission
26 Federal Plaza
New York, New York 10007

Re: United States v. Stanley Goldblum et al. CR 13390-JWC-CD

Dear Mr. Deitz:

Pursuant to your request enclosed please find a copy of a summary of the convictions in the above-entitled matter.

If we can be of further assistance to you, please let us know.

Very truly yours,

WILLIAM D. KELLER
United States Attorney

/s/

WILLIAM JOHN RATHJE
Assistant Chief,
Criminal Division

Enclosure

UNITED STATES v. GOLDBLUM, ET AL., CASE #13390-JWC-CD

DEFENDANT	GUILTY	SENTENCE
STANLEY GOLDBLUM	COUNTS 1, 10, 25, 70, 77	8 YEARS IMPRISONMENT AND $20,000 FINE
SAMUEL B. LOWELL	COUNTS 1, 24, 25, 26, 27	5 YEARS IMPRISONMENT
FRED LEVIN	COUNTS 1, 26, 91, 92	5 YEARS IMPRISONMENT
ARTHUR S. LEWIS	COUNTS 1, 47, 100	3 YEARS IMPRISONMENT
LLOYD D. EDENS	COUNTS 1, 63, 99	3 YEARS IMPRISONMENT
JAMES BANKS	COUNTS 1, 60, 97	3 YEARS IMPRISONMENT
JAMES C. SMITH	COUNTS 1, 44, 52	2 YEARS IMPRISONMENT
MICHAEL E. SULTAN	COUNTS 1, 24, 85	2 YEARS IMPRISONMENT
DAVID J. CAPO	COUNTS 1, 41, 42	2 YEARS IMPRISONMENT
LARRY G. COLLINS	COUNTS 1, 90, 98	2 YEARS IMPRISONMENT
WILLIAM MERCADO	COUNT 1	2 YEARS IMPRISONMENT - SUSPENDED: 6 MONTHS INCARCERATION (WORK FURLOUGH) PLUS 3 YEARS PROBATION
DONALD MC CLELLAN	COUNTS 1, 103	2 YEARS IMPRISONMENT - SUSPENDED: 6 MONTHS INCARCERATION (WORK FURLOUGH) PLUS 3 YEARS PROBATION

DEFENDANT	GUILTY	SENTENCE
LESTER M. KELLER	COUNTS 1, 30	2 YEARS IMPRISONMENT - SUSPENDED: 3 MONTHS INCARCERATION (WORK FURLOUGH) PLUS 3 YEARS PROBATION
ALAN L. GREEN	COUNTS 1, 53	2 YEARS IMPRISONMENT - SUSPENDED: 3 MONTHS INCARCERATION (WORK FURLOUGH) PLUS 3 YEARS PROBATION
JEROME H. EVANS	COUNT 1	1 YEAR IMPRISONMENT- SUSPENDED: $5,000 FINE PLUS 2 YEARS PROBATION
GARY S. BECKERMAN	COUNT 1	2 YEARS IMPRISONMENT - SUSPENDED: $1,000 FINE PLUS 1 YEAR PROBATION
WILLIAM E. SYMONDS	COUNT 1	2 YEARS IMPRISONMENT - SUSPENDED: $1,000 FINE PLUS 1 YEAR PROBATION
MARK C. LEWIS	COUNT 1	2 YEARS PROBATION
RICHARD GARDENIER	ONE COUNT OF A SUPERSEDING INFORMATION	3 YEARS PROBATION
JULIAN S. H. WEINER	COUNTS 6, 10, 11, 12, 13, 14, 75, 78, 80, 84	2 YEARS IMPRISONMENT - SUSPENDED: 3 MONTHS INCARCERATION PLUS 4 YEARS PROBATION AND 2,000 HOURS OF COMMUNITY SERVICE

DEFENDANT	GUILTY	SENTENCE
MARVIN A. LICHTIG	COUNTS 6, 10, 11, 12, 13, 14, 75, 76, 77, 79, 81, 82, 83	2 YEARS IMPRISONMENT - SUSPENDED: 3 MONTHS INCARCERATION PLUS 4 YEARS PROBATION AND 2,000 HOURS OF COMMUNITY SERVICE
SOLOMON BLOCK	COUNTS 10, 11, 12, 13, 14, 80, 84 (NOT GUILTY COUNTS 6, 78)	2 YEARS IMPRISONMENT - SUSPENDED: 3 MONTHS INCARCERATION PLUS 4 YEARS PROBATION AND 2,000 HOURS OF COMMUNITY SERVICE

ALL REMAINING CHARGES AGAINST
ALL DEFENDANTS HAVE BEEN DISMISSED.

DIRKS EXHIBIT D

Administrative Proceeding
File No. 3-5068

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

THE BOSTON COMPANY INSTITUTIONAL INVESTORS, INC. *et al.*

STIPULATIONS BETWEEN THE DIVISION OF ENFORCEMENT AND RAYMOND L. DIRKS

It is hereby stipulated between the Division of Enforcement and Raymond L. Dirks, as follows:

* * *

STIPULATION NO. 12

Neither Raymond L. Dirks nor the company at which he was then employed made any trade of Equity Funding stock or debentures during March 1973.

STIPULATION NO. 13

Neither Raymond L. Dirks nor the company by which he was then employed received any commission, bonus, compensation or other remuneration, directly or indirectly, from any person to whom Mr. Dirks provided information concerning Equity Funding.

* * *

DIRKS EXHIBIT P

February 14, 1972

MEMORANDUM OF PERSONAL INTERVIEW

Person Interviewed:	William Thomas Mercado 5711 Mistridge Road Palos Verdes Peninsula, California 90274 Home phone: (213) 377-7594 Current Business Address: The Larwin Company 9100 Wilshire Blvd. Beverly Hills, California 90212 Telephone: (213) 878-3550
Persons Conducting Interview:	Martin I. Robins, Attorneys Walter McCormies, Attorneys Los Angeles Branch Office
Date and Place of Interview:	February 2, 1972 Los Angeles Branch Office
Subject:	Equity Funding Corporation of America

Mr. Mercado's employment with the Larwin Company begins on February 7, 1972. His position will be Director of Corporate Management Systems.

Memorandum of Personal Interview
Equity Funding Corporation of America
February 14, 1972

His previous employment with Equity Funding Corporation of America (Equity) began on October 15, 1969. From October 15, 1969 to March 15, 1970, he was Director of Financial Services. From March 15, 1970 to July 1, 1971 he was Director of Corporate Management Information and from July 1, 1971 to January 28, 1972 he was Director of Corporate Planning and Development. Mercado stated that although he left Equity on January 28, 1972, he told Stanley Goldblum, president of Equity, that his services were available until February 4, 1972. However, they had not as of the date of this interview requested his services.

He stated that he had resigned when asked why he was no longer employed by Equity. When asked why he had resigned, he stated that it was due to serious disagreements with his immediate supervisor, Samuel B. Lowell (Lowell). When asked for specifics, he stated that Lowell had continuously interferred in his (Mercado's) areas of responsibility and decision making. He told us that since he was being paid as an executive officer to carry out certain responsibilities and make decisions with respect to such responsibilities, he felt that he should have been permitted to do so without Lowell's constant interference. He went on to say that he had brought such matters to the attention of Goldblum but felt the president had not acted to resolve the situation. Hence, he resigned.

During the interview Mercado diagramed Equity's table of organization (Attachment 1). However, he told us that the three persons who really ran the organization were: Stanley Goldblum, the president; Samuel B. Lowell, executive vice-president, finance; and Fred Levin, executive vice-president, Marketing. He also diagramed what he could recall as to Lowell's immediate responsibilities (Attachment 2) and Levin's immediate responsibilities (Attachment 3).

Mercado also told us that Equity Funding Corporation of America was more of a holding company than an operating

company and that its real function was to supervise and control about twenty (20) totally owned subsidiaries. Several such subsidiaries named by him were: Equity Funding Life Insurance Co. (a California corporation); Bankers' National Life Insurance Co. (corporate offices in New Jersey); North American Equity Securities Corp. (a California based registered broker-dealer); and Bishop's Bank (a Bermuda based bank). He said that the corporation, through its subsidiaries, had a sales force of about 8,000 salesmen, all duly licensed to sell life insurance and securities.

Mercado's responsibility as Director of Corporate Planning and Development (the last position that he held) was in the computer programming area. All information considered relevant about subject corporation or its subsidiaries went into the computers. While he is an accountant by education and experience, it was not his responsibility to prepare, review or verify accounting information before it was put into the computer system. He stated that accounting information was tightly controlled by Lowell and Michael Sultan (in charge of the Corporate Controllership Division). He told us he had heard many rumors about the company, particularly during the early days of his employment, but that he has no present personal knowledge of any questionable accounting practices being performed and, further, he has no reason to believe that there are any such questionable practices being committed.

He recalled that when he first started to work he went to the president and told him about these rumors. Goldblum assured him that there was no basis for them. He also said that when he first came with the corporation, he observed several questionable accounting practices which he did not specify. He further stated, however, that he was of the opinion that they had occurred because the corporation had been founded by salesmen and was sales oriented and did not have qualified accountants who could have prevented such practices. Since then, he

said the corporation has employed qualified accountants and there has been considerable improvement in accounting operations. If proper accounting and business practices are not presently being followed, he would blame it on lack of experience and expertise on the part of the executive officers (who are mostly in their thirty's) and lack of control by those same officers due to their numerous and variant responsibilities. He stated that some have as many as thirty or forty specific responsibilities.

Mercado has always found objectionable the fact that many of the subsidiaries have their corporate audits performed by nationally known audit firms, such as Haskins and Sells and Peat, Marwick, but that the holding corporation is audited by the small local firm of Wolfson Weiner Ratoff and Lapin. That, of course, makes the latter firm responsible for reconciling all of the audits performed on the subsidiaries by the larger auditing firms. The president's explanation for doing it that way was that the local firm had been auditing them for a long time. Mercado named Sol Block as the person in charge of the auditing for Wolfson Weiner Ratoff and Lapin. The firm's address is 8899 Beverly Boulevard, Los Angeles, California 90048, telephone: (213) 272-4181.

Mercado told us that while his feelings about the company are not friendly, he is satisfied that management at this time is interested in improving its accounting practices and is doing so.

In response to an inquiry as to anyone who had recently left the company who might have personal knowledge of the inside working of the company, Mercado stated that a Mr. Leone, who was staff assistant to Lowell, left the corporation about eight months ago and that he had worked under Lowell for about a year. Mercado thought Leone may have been terminated but doesn't know what the reason would have been for the

termination. He believes that Leone is now locally employed by Washington Thrift & Loan and that he would have a more first hand knowledge of the accounting and bookkeeping practices of the company.

Martin I. Robins
Attorney

Walter McCormies
Attorney

Attachments

cc:SFRO
MIR/mla

DIRKS EXHIBIT Q

May 8, 1972

MEMORANDUM OF INTERVIEW

Persons Interviewed:	James Jess 606 South Hill Street Los Angeles, California and William Thomas Mercado 5711 Mistridge Road Palos Verdes Peninsula, California
Person Conducting Interview:	Martin I. Robins, Attorney Walter McCormies, Attorney Los Angeles Regional Office
Date and Place of Interview:	May 5, 1972 Los Angeles Regional Office
Subject:	Equity Funding Corporation of America

On the above date Mr. Jess, an attorney, visited this office with his client, Mr. Mercado, who had been informally interviewed on February 2, 1972 by staff attorneys Robins and McCormies. Mr. Mercado had appeared on that date without an attorney as the result of a telephone call from Mr. Robins requesting information about the operation and accounting practices of the Equity Funding complex, by whom he had recently been employed (see memorandum of interview dated February 7, 1972). Mr. Mercado had come to this office at his own suggestion as he preferred that to giving information over the telephone. At the time of the interview on February 2, 1972 he had been advised that he could have an attorney present. He chose to be interviewed without his attorney, stating that he did not feel it necessary that one be present.

To start the meeting of May 5, 1972, Mr. Jess was asked why he had asked us to see him. He advised that Mr. Mercado had previously talked to us without an attorney being present and was concerned that he may have given information which might tend to incriminate him. He was informed that Mr: [*sic*] Mercado had appeared voluntarily and had been advised of his rights, even though we did not consider him to be a target of our inquiries. He was advised that if Mr. Mercado's information had indicated that it might involve violations by him, he would have again been told of his right against self-incrimination and, if appropriate, our interview would have been suspended until he could appear with an attorney. Mr. Mercado agreed that he did not feel he had been questioned unfairly.

Mr. Jess explained that since he was inexperienced in securities matters, he had discussed the circumstances of our questioning his client with other attorneys who had dealt with this office. These attorneys had indicated that they would not permit their clients to give any testimony to the SEC because they could never tell in what way it might be used against them. Mr. Jess observed that while he was reassured by this interview that we had not sought to trap his client into damaging statements, he would nevertheless feel more at ease if we would give his client a grant of immunity.

It was explained to Mr. Jess that members of the staff had no authority to make such a grant. That such grants could only be given by the Commission and the U.S. Attorney.

It was suggested to Mr. Jess that if Mr. Mercado had any additional information or leads to furnish with respect to any specific accounting practices by Equity we would be happy to receive it. He stated that he would discuss the matter further with Mr. Mercado to determine whether he might be in possession of such information. If he found this to be so, and that such information could be given to us without any self-incrimination by his client, he would be in touch with this office again.

Before leaving, both Mr. Mercado and Mr. Jess indicated that they were also concerned with Mr. Mercado's status in his new position if it became known that he had talked about the company which had previously employed him. Mr. Mercado remarked that Equity Funding was a big company with a lot of economic power, and that he did not want to jeopardize his future.

Martin I. Robins
Attorney

Walter McCormies
Attorney

DIRKS EXHIBIT R

Office Memorandum SECURITIES AND EXCHANGE COMMISSION

Date: August 31, 1973

TO : Irving M. Pollack
Division of Enforcement

FROM : Gerald E. Boltz, Administrator
Los Angeles Regional Office

SUBJECT: Equity Funding Corporation of America
(File No. LA-46)

Pursuant to the Request received through the Division of Enforcement on August 29, 1973 for a chronology of events relating to the subject company in March, 1973, the following information is supplied:

Friday, March 23, 1973[1]

Ralph H. Erickson, Assistant General Counsel, Los Angeles Regional Office, received a telephone call from William Blundell, Bureau Chief of the Los Angeles office of the Wall Street Journal, inquiring whether the Commission was investigating Equity Funding. Mr. Erickson furnished no information but suggested Blundell may wish to speak with Stan Sporkin, Deputy Director, Division of Enforcement. Later that day Gerald E. Boltz, Regional Administrator, received a telephone call while he was at home ill, wherein Sporkin advised that Blundell had called him and that Blundell had information concerning some possibly fraudulent activity at Equity Funding. Gerald Boltz thereupon called Ralph H. Erickson to discuss setting up an appointment with Blundell to obtain this

[1] This chronology begins on March 23, 1973 as that was the first day we began to obtain information indicating a substantial fraud at Equity Funding. (See Background Section of this memo for events occurring prior to March 23, 1973.)

information. John Peloso of the New York Regional Office called Mike Donahue of the Los Angeles office to advise he heard rumors on the "street" re Equity Funding, but no details.

Monday, March 26, 1973, 11:40 a.m.

Ralph H Erickson received a telephone call from Herb Lawson, Wall Street Journal, who indicated that there was talk in the street concerning what may be the "biggest insurance fraud in history" at Equity Funding.

11:45 a.m.

Erickson telephoned Sporkin reporting Lawson's comments and discussed possible trading suspension.

11:55 a.m.

Erickson called the Los Angeles office of Haskins & Sells to discuss financial statements of Equity Funding.

Initial phone call resulted in two additional telephone conversations with Haskins & Sells' offices that afternoon; no information tending to verify rumors was obtained; company filings and financial statements examined by staff.

In Washington, Sporkin advises Commission of possible problem at Equity Funding.

6:00 p.m.

Messrs. Boltz, Erickson and Les Ogg of the Los Angeles office met with William Blundell at the Los Angeles offices of the Wall Street Journal. Blundell recited in some detail information he had obtained from former employees of Equity Funding and further described the activities of one Ray Dirks in obtaining similar information. Blundell expressed his concern as to the reliability of the information and stated he was not sure his informants would talk to the SEC. Blundell was requested to contact his informants that evening in an attempt to convince them to come to the SEC with their information. Subsequently, Gerald Boltz received telephone calls at his home at approximately 8:00 to 9:00 p.m. from Messrs. Majerus and Hopper,

wherein they offered to furnish information concerning Equity Funding to the Commission. Boltz asked them to appear the following morning to give statements.

Tuesday, March 27, 1973

Messrs. Dirks, Majerus and Hopper appeared in the morning and were introduced by Blundell. Majerus' statement was initially taken off-the-record by Boltz and Mike Donahue (LARO) (later on April 2 his on-the-record statement was taken). Concurrently, Messrs. Dirks and Hopper were interrogated on-the-record throughout the day on March 27 (these interrogations continued throughout the balance of the week). Conversations were also held between members of the staff and Larry Williams, Compliance Counsel for Equity Funding, wherein it was requested that the principal executives of the company and the company's accountants appear for an on-the-record interrogation on Thursday, March 29 in this matter. Further, the principal executives were urged to immediately furnish affidavits denying all rumors of fraud. Boltz conferred in a telephone conversation with Stan Sporkin and Irving M. Pollack. Discussion centered on whether we were witnessing a "bear" raid accompanied by the intentional dissemination of rumors or an actual fraud at the company, or both. It was finally agreed that based upon information and testimony just obtained from Majerus and Hopper, as well as recent market activity in Equity Funding stock sales, that trading should be suspended by the Commission immediately; this recommendation was presented to the Commission. The staff also met with the State of California Department of Insurance; we were apprised that they had no further information to furnish. Ogg and other staff members related information obtained by the Commission staff to the state officials. Goldblum issued press release denying rumors.

Wednesday, March 28, 1973

SEC trading suspension in effect. Additional testimony and statements taken of witnesses Dirks, Ballint and Hill (the latter two being partners of Haskins & Sells). Further inquiry

of Larry Williams at Equity Funding re progress made on affidavits from company officials. Williams complained that the Commission's suspension of trading, which had been announced, was unjustified and terribly damaging to the company. Other members of the staff were involved in reviewing the company's filings with the Commission, checking information from brokers for possible insider sales and other related market activity.

Thursday, March 29, 1973

Larry Williams advised the staff that they were experiencing a delay in obtaining affidavits, that some of them might not be forthcoming and that interrogation must be delayed until next day. Executives of Equity Funding might retain personal counsel. Other aspects of the investigation continued. Recommendation for injunctive action discussed with home office. Representatives of First National City Bank provide information to Division of Enforcement of illegal Equity Funding activities.

Friday, March 30, 1973

An on-the-record conference and interrogation of representatives of Seidman & Seidman and Haskins & Sells (also present was Larry Williams of the company). Following this interrogation, Williams furnished information indicating that Stanley Goldblum, president of Equity Funding, might have been selling securities of Equity Funding through Dishy-Easton & Co. Telephone calls were placed to the Division of Enforcement, Mr. Sporkin, who in turn contacted Dishy-Easton in order to freeze funds and securities in the Goldblum account. Other broker-dealers likely to have accounts for insiders of Equity Funding were checked in an attempt to freeze funds or securities therein. Equity Funding retained Buchalter, Nemer, Fields & Savitch law firm as general counsel. Conferences held with the Buchalter firm; company employees interviewed.

State of California Department of Insurance urged by staff to seize company to preserve records.[2]

Saturday, March 31, 1973

Conferences held between the staff, company counsel and members of the board of Equity Funding. Also a conference held with Seidman & Seidman relating information they were volunteering. Discussion also held re integrity of the company's records, preventing the erasure of tapes, etc.

Sunday, April 1, 1973

Further conferences with company counsel and certain employee informants were questioned concerning board of directors meeting held that day wherein officers of Equity Funding resigned. Complaint for injunctive and other moving papers prepared and discussions held concerning possible Court appointed board based upon the suggested resignation of all present directors of Equity Funding. Discussion also held concerning appointment of a special investigator for Equity Funding by the Court. Met with bank officials re company's outstanding loans.

Monday, April 2, 1973

Commission injunctive action filed alleging a scheme to defraud in violation of Section 10b and Rule 10b-5 and false filings by Equity Funding. Conference held with U. S. District Judge Harry Pragerson. Candidates for possible board members contacted. Attorney Lewis Merriefield contacted re possible appointment as special investigator. Initial Wall Street Journal article appears describing Equity Funding fraud. Conferences

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[2] The California Insurance Department was not fully convinced we had sufficient evidence to warrant seizure, but agreed to this procedure. Larry Baker, Deputy Commissioner, later stated: "At that point we had not found one fake policy. We had nothing but stories. Our hearts were in our mouths."

held with principal bank lenders re further extensions of credit to Equity Funding.

Tuesday, April 3, 1973

Equity Funding Corporation of America consents to an order of permanent injunction, a Court appointed board of directors and appointment of a special investigator. Conferences held by the staff with Buchalter, Nemer, Fields & Savitch re company's financial and operational crisis.

Wednesday, April 4, 1973

Further conference with company counsel re company's condition. Further information obtained in an attempt to avoid reorganization under the Bankruptcy Act from employees and other informants re nature of fraud.

Thursday, April 5, 1973

Equity Funding Corporation of America files a petition under Chapter X of the Bankruptcy Act.

Background

During the 1968-1971 period, the Los Angeles office received complaints about the "back office" operations of Equity Funding resulting from delays in effecting customer orders. The staff made inquiries, and as a result the company changed certain procedures and hired an experienced compliance counsel in 1969.

In late 1971 a local attorney reported hearing of possible misstated assets due to improper accounting at Equity Funding. An inquiry was undertaken wherein present and former financial officers and accountants of the company were interrogated. This inquiry indicated that in the early 1960's the company had been managed by essentially "sales" people, who had not emphasized record keeping, so that by the mid 1960's the records were in a poor state. Subsequently, the company had corrected this situation by hiring several qualified accountants. Present and former officials questioned furnished no information concerning any other improper practices. (Sub-

sequent investigation in mid 1973 showed that at least one of these witnesses withheld information from the staff and apparently attempted to shake down Equity's management in return for not divulging the true facts about the company.) In January, 1972 the Los Angeles office recommended a scheduled 600-man-hour mutual fund inspection at Equity. The staff proposed to the California Corporation Commission and the California Insurance Department the formation of a joint task force to conduct inspections of several local insurance funding type companies. This was proposed in view of the substantial manpower requirements of these inspections.[3] Subsequently, an inspection was conducted of Zenith Funding Corporation as, in part, a training exercise for the task force group, preparatory to inspecting the much larger Equity Funding.

On March 9, 1973 Edward Germann of the California Department of Insurance discussed Equity Funding with Les Ogg, Chief of the Investment Company Unit in Los Angeles (see attached memorandum). Ogg concluded that Germann furnished no new information but requested Germann to obtain further details and provide us with the information.[4] On March 12 an inspector from the state of Illinois commenced an

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[3] The Los Angeles office was then a branch office with approximately 25 employees. In April, 1972 the newly appointed Regional Administrator, Mr. Boltz, caused the office to become a regional office, and the staff was increased although such was limited by government and Commission employment freezes. (The Los Angeles office Investment Company Inspection Unit then consisted of two attorneys and one examiner, who were also responsible for all regional investment company investigations and litigation.)

[4] Due to a then pending court hearing re *SEC* v. *Goldstein Samuelson, Inc.*, secretarial personnel did not transcribe Ogg's memorandum, dictated March 9, until March 16. The memorandum was routed to Mr. Boltz who first saw it on March 26, 1973, as he was at home ill during the previous week.

examination at Equity Funding Life Insurance Company and was joined on March 16 by an examiner from the California Department of Insurance. However, by March 30 they had not found any fake policies or other falsified records.

Attachment

GEB/rl

BOSTON CO. III
EXHIBIT HHH

March 16, 1973

Gerald E. Boltz

Leslie L. Ogg

Equity Funding Corporation
811-278

RE: Conference between Edward J. Germann, Division Chief, Company Information and Analysis Division, State of California - Department of Insurance and Leslie L. Ogg on March 9, 1973 at 2:00 p.m.

Mr. Germann stated that he had received a telephone call from the Insurance Commissioner's Office, State of New York. This telephone call was precipitated by the proposed acquisition of three affiliated insurance companies by Equity Funding Corporation (Equity Funding), the major one of which is incorporated in New York, while the other two are a California corporation, and a Dutch corporation. While this acquisition must ultimately be approved by the California Department of Insurance, no application has yet been filed.

The New York Insurance Commissioner's office was concerned because an informant, an ex-employee of Equity Funding in New Jersey, had come to their offices alleging that Equity Funding was overstating assets on their financial statements, issuing confirmations for sale of Fund's shares - which shares were in fact not issued until some later date, and delaying the payments for a substantial period of time to investors and policy holders who canceled programs.

Mr. Germann stated that when his office received the application from Equity Funding to acquire these three insurance companies, that he had 60 days in which to act. He said he felt that his superiors were going to demand a full inspection of Equity Funding's operations because of the question raised by New York and asked what assistance I could be. I advised Mr.

Germann that similar allegations had been made before regarding this company and attempted to explain the Equity Funding program to him. He stated that it is possible this informant was an officer, perhaps a controller of the corporation, and if so, felt that such information probably was more substantial than past disgruntled employees. I agreed and suggested that he obtain as much detailed information as possible from the informant and that upon receipt of this information, we would set down with the Division of Insurance, as well as the Department of Corporations, and decide what type of task force might prove productive in this matter.

However, if the informant cannot give detailed information, I suggest delaying any type of inspection of the Equity Funding operations until next year when more personnel are available.

LLO:md

ADMINISTRATIVE PROCEEDING
FILE NO. 3-5068

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

THE BOSTON COMPANY INSTITUTIONAL INVESTORS, INC.
JOHN W. BRISTOL & CO., INC.
RAYMOND L. DIRKS
THE DREYFUS CORPORATION
MANNING & NAPIER
TOMLIN, ZIMMERMAN & PARMELEE, INC.

INITIAL DECISION

APPEARANCES:

Donald N. Malawsky, Associate Administrator, Enforcement, New York Regional Office; Jason R. Gettinger and Andrew N. Karlen, Attorneys; and Roger M. Deitz, Special Counsel, for the Division of Enforcement. Paul S. Maco assisted on the reply brief.

Marshal Simonds, Thomas J. Griffin, Jr. and Carol Goodman, of Goodwin, Procter and Hoar, Boston, Mass., for Respondent The Boston Company Institutional Investors, Inc.

Peter M. Brown, Claude P. Bordwine and Howard W. Burns, Jr., of Cadwalader, Wickersham & Taft, New York, N.Y., for Respondent John W. Bristol & Co., Inc.

David Bonderman and David Hird, of Arnold & Porter, Washington, D.C., for Respondent Raymond L. Dirks.

Lawrence Greenwald and Bruce H. Schneider, of Stroock & Stroock & Lavan, New York, N.Y., for Respondent The Dreyfus Corporation.

Robert C. Napier, of Napier & Lapine, Rochester, New York, for Respondent Manning & Napier.

Robert A. Meister, of Milgrim Thomajan & Jacobs, New York, N.Y., for Respondent Tomlin, Zimmerman & Parmelee, Inc.

BEFORE:

David J. Markun
Administrative Law Judge

I

THE PROCEEDING

This public proceeding was instituted by an Order of the Commission dated August 24, 1976, as amended on September 10, 1976 and on October 12, 1977 ("Order"), pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934[1], Section 203(e) of the Investment Advisers Act of 1940[2], and Section 9(b) of the Investment Company Act of 1940[3], to determine whether one individual respondent and five corporate respondents wilfully violated or wilfully aided and abetted violations of Section 17(a) of the Securities Act of 1933[4] or Section 10(b) of the Exchange Act of 1934 and Rule 10b-5 thereunder[5], and the remedial action, if any, that might be appropriate in the public interest. In substance, the allegations of the Division of Enforcement ("Division") contained in the Order charge violations of the rule against inside information trading in connection with various sales of the securities of Equity Funding Corporation of America in March of 1973 by the five corporate respondents on behalf of their clients.

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[1] 15 U.S.C. § 78o (b); 15 U.S.C. § 78s (h).

[2] 15 U.S.C. § 80b—3(e).

[3] 15 U.S.C. § 80a—9(b).

[4] 15 U.S.C. § 77q(a).

[5] 15 U.S.C. § 78j (b); 17 CFR 240.10b-5.

The evidentiary hearing was held in New York, New York, and, in part, in Los Angeles, California. All parties have been represented by counsel thoughout [*sic*] the proceeding. The parties have filed proposed findings of fact and conclusions of law and supporting briefs pursuant to the Commission's Rules of Practice (17 CFR 201.16). Respondents filed both joint proposed findings and conclusions and supporting memorandum and individual proposed findings and conclusions and memoranda.

The findings and conclusions herein are based upon the record and upon observation of the demeanor of the various witnesses. The standard of proof applied is that requiring proof by clear and convincing evidence.[6]

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[6] The Court of Appeals for the District of Columbia Circuit has held that in an administrative proceeding brought by the Commission to determine whether a broker-dealer and its president had violated antifraud provisions of the federal securities laws and in which the sanction in question involved "an expulsion or a substantial suspension order" the "clear and convincing" standard of proof rather than the long-standing "preponderance of evidence" standard of proof should have been applied. *Collins Securities Corporation* v. *S.E.C.*, 562 F. 2d 820, decided Aug. 12, 1977, as amended on denial of request for rehearing September 23, 1977. Although a petition for certiorari from the Supreme Court was not sought in *Collins*, the Commission has continued to assert in other proceedings that the preponderance of the evidence standard is legally sufficient in all administrative proceedings under the securities laws, e.g. *Charles W. Steadman* v. *S.E.C.*, No. 77-2415, currently pending in the Court of Appeals for the Fifth Circuit, an appeal from the Commission's decision in *Steadman Security Corporation, et al.*, Investment Company Act of 1940, Release No. 9830, June 29, 1977, 12 SEC Docket 1041, July 12, 1977. In the *Steadman* appeal the Commission urges that *Collins* conflicts with an earlier decision of that same circuit (*Abbett, Sommer & Co., Inc.* v. *Securities and Exchange Commission*, ['70-'71] Fed. Sec. L. Rep. [CCH] ¶ 92,813 (1970), cert. den., 401 U.S. 974 (1971)); with decisions of the Court of Appeals for the Second Circuit (*De Mammos*

II

FINDINGS OF FACT AND LAW

A. The Respondents; Background Concerning Their Knowledge Of And Interest In Equity Funding Prior To Hearing Alleged Inside Information In March, 1973.

EFCA

As noted, the corporation in whose securities the alleged illegal transactions occurred in violation of the inside-information proscription was Equity Funding Corporation of America ("EFCA" or "Equity Funding"), a California corporation with principal offices in Los Angeles. EFCA is not a respondent but some findings concerning it are essential to understanding related findings and conclusions.

From 1960 to 1966 EFCA had been essentially a marketing organization selling life insurance, shares in mutual funds, and funding programs combining the two. In 1967 it had embarked upon a diversification program that included the acquisition of investment companies, insurance companies, marketing com-

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v. *S.E.C.*, C.A. 2, No. 31469 (Oct. 13, 1967), affirming *James De Mammos*, 43 S.E.C. 333 (1967); *Wright* v. *S.E.C.*, 112 F. 2d 89 (C.A. 2, 1940); and with a long line of the Commission's decisions (*Richard C. Spangler, Inc.*, Securities Exchange Act Release No. 12104, 8 *SEC Docket* 1257 (February 12, 1976), *remanded on other grounds sub nom. Nassar and Co.* v. *Securities and Exchange Commission*, ['77-'78] Fed. Sec. L. Rep. [CCH] ¶ 96,185 (C.A. D.C., October 3, 1977); *Sidney Leavitt*, Securities Exchange Act Release No. 10013, 1 SEC Docket 1 (February 22, 1973); *M.V. Gray Investment, Inc.*, 44 S.E.C. 567, 575 (1971); *In re Norman Pollisky*, 42 S.E.C. 458, 459-460 (1967); *Underhill Securities Corp.*, 42 S.E.C. 689, 695 (1965); *White and Weld*, 3 S.E.C. 466, 539-540 (1938).) In view of the conflict among the Circuits on this point and in light of the forums available on any appeal that may be taken, it is concluded that the more appropriate course is to apply the "clear and convincing" standard of proof in this proceeding.

panies, a savings and loan association, certain foreign operations, partnerships in oil and gas exploration and cattle breeding, and a real estate development enterprise. Thus, by March, 1973 EFCA had taken on the aspect of a substantially diversified enterprise; nevertheless, its primary business continued to be sales of life insurance, mutual funds, and funding programs combining the two.

EFCA's insurance business was conducted through its subsidiaries, Equity Funding Life Insurance Company, domiciled in Illinois but with its principal offices in Los Angeles ("EFLIC"), Bankers National Life Insurance Company, Parsippany, New Jersey ("Bankers" or "Bankers National"), Northern Life Insurance Company, Seattle, Washington ("Northern"), and Equity Funding Life Insurance Company of New York, New York, a subsidiary of Bankers ("EFNY"). EFLIC's insurance products were marketed by EFCA's sales force, whereas the other insurance subsidiaries of EFCA primarily utilized general agents.

EFCA first issued its securities to the public in 1964. From time to time thereafter, EFCA issued notes, convertible debentures, and similar securities to the public.[7] Each of these was issued pursuant to a registration statement filed with the Commission. During this period EFCA filed periodic reports with the Commission pursuant to the Exchange Act.

EFCA common stock and its 5½ percent convertible subordinated debentures due in 1991 ("convertible debentures" or "debentures") were listed and traded on the New York Stock

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[7] These issues consisted of $2 million of 5½ percent capital subordinated notes due in 1980 with common stock purchase warrants, issued in 1965; $6 million of 5½ percent convertible debentures due in 1982, issued in 1967; $22 million of 9½ percent debentures due in 1990 with common stock purchase warrants, issued in 1970; and $38 million of 5½ percent convertible subordinated debentures due in 1991, issued in 1971.

Exchange. EFCA warrants were listed and traded on the American Stock Exchange.

Dirks

In March of 1973 Respondent Raymond L. Dirks ("Dirks") was a security analyst specializing in insurance stocks at Delafield Childs, a broker-dealer in New York, New York, having exclusively institutional clients. Earlier, in 1969, Dirks and his brother had formed a broker-dealership known as Dirks Brothers; that business was dissolved when Dirks joined Delafield Childs in December, 1971, where he became a senior vice president in charge of the Dirks Brothers Division, a research group comprising Dirks, his brother (whose expertise was in another area) and four other analysts that specialized in insurance stocks. Dirks's clients were exclusively institutions such as large commercial bank trust departments, investment companies, foundations, hedge funds, and other entities that managed securities portfolios.

The Dirks Brothers Division distributed information about and analyses of insurance companies to approximately 500 actual or potential institutional clients. Written reports were provided monthly on two or three companies and a statistical analysis covering about 50 companies was also issued about once a month. In addition to publishing materials, Dirks and his fellow analysts also contacted clients and potential clients personally with respect to insurance company securities.

Compensation for these analytical services of the Dirks Brothers Division was obtained indirectly from securities transactions directed by their clients through the Delafield Childs trading department. Such securities transactions did not necessarily or even usually involve insurance securities that were analyzed by Dirks Brothers.

Following graduation from college in 1955, Dirks until 1967 had been employed mainly as a securities analyst for various banks and firms.

On August 31, 1972, Dirks was the subject of a "profile" style article in the *Wall Street Journal*, which touched upon his background and methods as an analyst, and included evaluations of him, albeit sketchy, by his analyst peers. The article was generally favorable to Dirks, and among other things emphasized his dogged and sometimes innovative means for digging into relevant facts about a company. The article was written in the context of the difficulties small securities analyst firms were then experiencing and suggested that for at least some of them specialization might be the key to their survival.

While Dirks had not made any special analysis of Equity Funding, he was generally familiar with it from the time of its public offerings in the early '60s and had occasion from time to time to comment on the firm in conversations with other securities analysts and portfolio managers, and at least once in a written comment in the Dirks Brothers publication "Insurance Confidential - Ideas on Insurance Stocks" of February 15, 1972.

In 1971, at the request of EFCA's public relations firm, Dirks held a luncheon at which Stanley Goldblum, Chairman of the Board of Equity Funding, and other officers of EFCA, including Fred Levin and Sam Lowell, spoke to a gathering of analysts and portfolio managers.

Sometime after the day of the luncheon, Goldblum asked Dirks to attempt to ascertain whether Allen Abelson of *Barron's* was about to publish a (apparently unfavorable) story about EFCA, and Dirks did so, reporting that on the basis of his guarded inquiries he did not think there would be a report.

In early 1972, Goldblum called at Dirks's office and invited him, with another, to breakfast. Among other things discussed was EFCA's recent acquisition of Bankers National Life of New Jersey.

Dirks's other contacts with EFCA personnel prior to March of 1973 included encountering Fred Levin, Executive Vice President of EFCA and President of EFLIC, at a party, and

one meeting and a number of phone conversations with Patrick Hopper, then EFCA's Vice President for Investment.

Respondent III

Respondent The Boston Company Institutional Investors, Inc. ("III"), a Massachusetts corporation having its principal place of business in Boston, has been registered since 1970 as an investment adviser under Section 203[8] of the Investment Advisers Act of 1940. Respondent III is a subsidiary of The Boston Company, Inc. ("TBC" or "The Boston Company"), a holding company. In March, 1973, 58% of III was owned by TBC and the balance was owned by III officers Thomas W. Courtney, president, David A. Baker, senior vice president, Grayson M.P. Murphy, senior vice president, and John Wise, Jr. Other officers of III included Daniel Fuss and Gerald S. Zukowski, both vice presidents. William R. Moore was the firm's trader.

III rendered its investment advisory services primarily to pension and profit-sharing plans for the benefit of employees of business corporations and governmental entities.

In March, 1973, Courtney, Murphy, Baker and Fuss had primary account responsibility for client portfolios. Zukowski had also been designated a portfolio manager by that time but as of March 7th he had been delegated primary account responsibility for only one client. Wise, responsible for various marketing and administrative matters, had no primary account responsibilities, though he did participate in the management of some portfolios in a secondary or tertiary capacity. Each account had a designated primary, secondary, and tertiary portfolio manager. III also followed a practice under which a negative vote by two portfolio managers could veto a proposed transaction in a client's account.

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[8] 15 U.S.C. § 80b—3.

Between May 27, 1971 and February 28, 1973, III purchased 408,000 shares of EFCA common stock at a cost of approximately $14,550,000 and $850,000 in face amount of EFCA debentures, at a cost of approximately $950,000, on behalf of 20 of its clients. By the end of February, 1973, EFCA was the third largest holding in III client portfolios.

III's initiation of purchases of EFCA securities in the Spring of 1971 and its continuation of such purchases through late 1972 had been prompted by the fact that EFCA had historically enjoyed an outstanding growth record within the insurance industry. EFCA stock had appeared to the III portfolio managers to represent one of the better values in the market place in view of its attractive price and very low price-earnings ratio as compared with comparable growth stocks for that period.

Beginning in about September, 1972, senior management of The Boston Company had become more active in reviewing the activities of III, particularly in the person of William W. Wolbach, then president and chief operating officer of TBC and also a director of III. TBC management had become concerned that a substantial percentage of the stocks purchased for the III portfolios were not stocks followed by or recommended by TBC's Investment Research and Technology arm ("IRT"), an investment research group, and were not on the so-called monitor list of stocks approved by the Investment Strategy Group ("ISG") of TBC. From that time forward Wolbach had kept pressing Courtney to have III establish new investment policy guidelines that would call for substantially greater use of TBC's monitor list of stocks. After a number of meetings and discussions among the III portfolio managers, they had arrived at an informal understanding in late January or early February that their revised investment guidelines would aim at having not less than 80% of the aggregate composition of III portfolios consist of monitored stocks by the end of 1973. To begin implementation of that objective, it had been agreed that purchases of non-monitored stocks would be curtailed.

Beginning about December of 1972, portfolio managers at III had begun their own internal, somewhat informal analysis of EFCA. Zukowski had recently joined III, and since he had had some background in insurance stocks, he was the portfolio manager who primarily concerned himself with looking into EFCA; however, since EFCA stock was held by other portfolio managers as well, they too gathered information and views and exchanged information and opinions with Zukowski and with one another. The inquiry had included a one-day visit by Zukowski and Baker to EFCA's offices in Los Angeles, where they conferred with EFCA's president and various other officials sometime before Christmas of 1972. After the visit to EFCA's offices, III portfolio managers continued to talk to outside analysts, broker-dealers, and others with respect to matters that bore on evaluation of EFCA as a holding.

In late December Zukowski had talked about EFCA to Ray Dirks, whom he had earlier come to know in the course of their employment in another firm, but had found that Dirks was not closely following EFCA.

By memorandum of February 2, 1973, Courtney had requested Zukowski to prepare a comprehensive report on EFCA to be submitted to the ISG with a view to getting EFCA placed on the monitor list of approved stocks. Zukowski's draft report,[9] given to Courtney sometime between February 13 and February 23, was also circulated among the other portfolio managers. The draft was in the main positive but it did call attention as well to a number of specific negative factors respecting Equity Funding. Zukowski recommended to Courtney that the report not be submitted to the ISG because of the negative factors. After some further discussions with Zukowski and after the draft report had circulated among the other portfolio managers, Courtney had decided not to submit the report that would have sought to get EFCA onto the monitored list.

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[9] Division's Ex. 20.

Earlier, on February 14, 1973, Zukowski and Wise had attended a luncheon in Boston sponsored by Edwards & Hanly for EFCA officers Stanley Goldblum, Fred Levin and Sam Lowell. After the luncheon, Goldblum and Levin had visited III's offices.

The upshot of it all was that at the close of February and during the first week of March, 1973, there was among the portfolio managers at III no clear consensus regarding EFCA. However, there was a *prevailing* view among them that they should await an anticipated rebound in the price of the stock to the low or mid 30s before considering sale of some or all of the EFCA securities.

Bristol & Co.

Respondent John W. Bristol & Co., Inc. ("Bristol & Co."), a New York corporation having its principal place of business in the City of New York, has been registered as an investment adviser under the Investment Advisers Act since 1954. John W. Bristol ("Bristol") is Chairman of the Board and Chief Executive Officer of Bristol & Co., and held such positions in March, 1973.

Since 1968 Bristol & Co. has been a wholly owned subsidiary of TBC. However, Bristol & Co., under an express provision of the acquisition agreement, has operated with total autonomy in its investment decisions and was so operating in March, 1973. Thus, Bristol & Co. did not during the relevant period discuss with TBC or TBC's other subsidiaries Bristol & Co.'s investment decisions or the composition of its clients' investment portfolios.

Bristol & Co. is and was during the relevant period engaged in rendering investment advisory services to various organizations, financial institutions, pension funds and foundations, including a number of endowment funds for various schools, colleges, and universities. As of December, 1972 its clients' portfolios totalled some $1.5 billion.

Between December, 1971, and March 22, 1973, Bristol & Co. purchased for its clients a total of 457,000 shares of EFCA common stock and $200,000 face value of its convertible debentures. The Bristol Employees Profit-Sharing Plan purchased 600 EFCA shares in January, 1973.

The purchases were made because of EFCA's reported outstanding growth rate within the specialty insurance industry; its reportedly strong sales force that marketed a unique investment package combining elements of life insurance and mutual fund shares and interrelated financing; its apparent position for capitalizing on the growing interest in, and the Commission's recent approval of variable annuities for purchase by mutual funds; and its very low price/earnings ratio relative to comparable growth stocks.

Notwithstanding these positive factors, three individuals from three separate investment committees functioning for Bristol & Co.'s clients had expressed dissatisfaction with or lack of enthusiasm for the EFCA securities purchases.

As late as March 21, 1973, John Bristol personally sought and obtained permission from the Investment Committee of Princeton University to purchase EFCA stock. Because of subsequent events that are detailed in Part II B below, only 66,000 shares of the intended larger purchase of EFCA shares were bought on March 22, 1973.

The Dreyfus Corporation

Respondent The Dreyfus Corporation ("Dreyfus") has been registered as an investment adviser under Section 203 of the Investment Advisers Act of 1940 since December 10, 1971. In March, 1973, Dreyfus was the investment adviser for several registered mutual funds, including the Dreyfus Fund ("DF") and the Dreyfus Special Income Fund ("DSIF"). At that time Michael L. Quinn was employed by Dreyfus as a portfolio manager. He began to assume responsibility for DSIF's equity investments shortly before or in March, 1973, sharing that

responsibility with Joseph DiMartino. Howard Stein was the chief investment officer for DF and DSIF.

In March of 1973 Anthony Orphanos was a securities analyst with Dreyfus, covering the insurance industry for all portfolio managers. Among the other sources he consulted, Orphanos used the Dirks Brothers insurance stocks report and consulted Allen Gorrelick, an associate of Dirks's, from time to time. Orphanos knew Dirks primarily by reputation.

Prior to March, 1973, Quinn was not acquainted with Dirks.

In early 1973 the Dreyfus Fund acquired a position in EFCA, which had only recently become an investment eligible for purchase by mutual funds.

On March 21, 1973, DSIF purchased from Goldman, Sachs, & Co., acting as principal, $500,000 face amount of EFCA convertible debentures at a net cost of approximately $388,937.

Manning & Napier

Respondent Manning & Napier ("M & N") in March, 1973, was a partnership that had been registered since May of 1970 as an investment adviser under Section 203 of the Investment Advisers Act. Its office was then and is now located in Rochester, New York.[10]

In March, 1973, M & N provided counseling on a full time basis to individuals and tax-exempt pension funds. William Manning was a managing partner; he had final decision-making authority within the firm over all equity purchases and sales for client accounts.

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[10] In late 1973 Manning and Napier Advisers, Inc., a corporation, succeeded to the business of M & N and became registered as an investment adviser under Section 203. William Manning and William Napier each own 50% of M & N Advisers.

As of March of 1973, M & N serviced some 90 to 100 clients and managed about $20-25 million in assets.

On May 18 and 19 and June 7, 1972, M & N had purchased a total of 5,975 EFCA common shares for 19 of their client accounts.

Manning had become concerned with the price action of EFCA stock in the second half of 1972 and as a result had sold the holdings of three clients, based in part on the risk he felt those clients could take. In February, 1973, he sold out another client's EFCA shares after deciding that she could not afford the risk of further price diminution.

During the last half of 1972 and the first quarter of 1973 Manning discussed EFCA with William Reeves, a sales agent in EFCA's Rochester, New York, office, whom Manning considered to be financially knowledgeable. These discussions occurred when the two would meet without prearrangement at a local pub for an hour or two on Friday nights.

Manning had discussed with Reeves during the first quarter of 1973 two specific rumors about EFCA: (a) that the New York State Department of Insurance was investigating and might reverse EFCA's recent acquisition of Bankers National, and (b) that First National City Bank might decline to renew EFCA's credit line. Reeves checked out those rumors with the manager of EFCA's Rochester office and with EFCA's Eastern Sales Manager and reported to Manning that there was no substance to either rumor.

Manning considered insider selling of EFCA stock of importance and had monitored it closely during the first quarter of 1973. In February he had asked Reeves about such sales. Reeves, after checking with his branch manager and with Herbert Glaser, an executive vice-president of EFCA who worked in EFCA's home office, had reported that such sales were all for personal reasons such as home improvements, tax payments, and the like. Manning had received such explanations with skepticism.

In January and February of 1973 Manning and Reeves had also discussed a recent change in the law that had enabled mutual funds to invest in EFCA stock. The extent of such purchases by mutual funds was not as great as Manning and Reeves had both expected it might be.

During February Manning had had an assistant, Karen Calvert, commence monitoring EFCA for daily price fluctuations. A small number of other stocks was similarly monitored.

In the first quarter of 1973 Manning's attitude towards EFCA had become progressively more pessimistic. For about a week to 10 days prior to M & N's liquidation of its clients' positions in EFCA, Manning had considered selling the stock for a variety of reasons, among which its negative price action figured perhaps most prominently.

TZP

Respondent Tomlin, Zimmerman & Parmelee, Inc. ("TZP") has been registered since September, 1972, as an investment adviser under Section 203 of the Investment Advisers Act. Its place of business in March of 1973 was, and is today, in New York, New York.

Donald R. Tomlin and Charles Zimmerman were principals of TZP in March, 1973, as they are today. Tomlin was then a portfolio manager and analyst who followed, among others, the insurance company stocks. Zimmerman then performed general investment work for all of the TZP accounts and was the firm's trader.[11] In the field of analysis of insurance company securities Tomlin had a reputation as a "knowledgeable guy."

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[11] When TZP was incorporated Alfred Parmelee had also been a principal of TZP and was such during the period relevant to this proceeding. However, he had nothing to do with the matters at issue in this proceeding and, by the time of the hearing in this proceeding he had withdrawn from the firm and had sold his interest in TZP to Tomlin and Zimmerman.

In March, 1973, TZP acted as investment adviser for some 11 accounts, which included pension funds, college endowments, and an insurance company. Assets under management totalled approximately $75 million.

Except for the insurance company,[12] which TZP merely advised and which made its own investment decisions, and two pension fund accounts which required oral approval of one trustee before TZP could execute transactions on their behalf, TZP's clients had given it discretionary power to purchase and sell securities for their accounts.

Tomlin and Zimmerman had commenced purchasing EFCA securities for clients in May, 1971, when they were principals of TZP's predecessor. EFCA was added to their "buy" list because research showed that the company was writing profitable life insurance, was increasing its sales at a greater rate than the average life insurance company, was showing greater earnings progress than the average life insurance company, and had come through a difficult period in the market as a continuing strong stock.

Between May, 1971, and March 23, 1973, TZP (and its predecessor) purchased for its clients' accounts some 25,920 shares of EFCA and $60,000 face amount of EFCA convertible debentures.

On March 13, 1973, Tomlin noted in the *Wall Street Journal* a report of a March 12, 1973 press release by EFCA, and on March 20, 1973, he received and read a copy of the release itself. The EFCA press release reported record earnings for 1972 and an increase in life insurance sales. EFCA as a consolidated entity was reported as having sold $2.5 billion of life insurance in 1972, bringing total insurance in force as of December 31, 1972 to $6.5 billion, compared with $4.6 billion at the close of 1971.

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[12] The insurance company did not purchase any EFCA securities.

B. Respondents' Receipt In March, 1973, Of Non Public Information Concerning Fraud At Equity Funding; Contexts In Which The Information Was Received; Responses To Receipt Of The Information; Recognition By Respondents Of The Probable Market Impact Of The Selective Dissemination Of The Information; Involvement, Role, And Activities Of Respondent Dirks.

Respondent III

At about 5:00 p.m. on March 12, 1973, Zukowski at III in Boston received a telephone call from Dirks in New York City. The call lasted 40 to 45 minutes. It concerned a story related to Dirks a few days earlier concerning EFCA by a former employee of EFCA. Dirks did not disclose the identity of the former employee because his informant had told him he feared for his life. Dirks was aware of III's interest in EFCA because of his discussion of EFCA with Zukowski in December of 1972.

The story, if it could be believed, was startling. Dirks said his source had alleged that one-third of the insurance policies carried on the books of EFCA's life insurance subsidiary, EFLIC, during 1969 and 1970 were fictitious. The phony business was known as "Y" business. It was also alleged that EFLIC would sell the phony insurance to other insurance companies through co-insurance or re-insurance arrangements and that it had created fake death certificates to help carry off the scheme. Dirks also stated his source had reported that EFLIC used different names and spellings of policyholders to help dupe the auditors.

Dirks also related that his source had told him that upper-level personnel had been leaving Bankers National, another EFCA subsidiary, in inordinate numbers, and that one had left because of concern over the transfer of a deposit from one bank to another.

Although prodded by Zukowski, Dirks refused to disclose the identity of his source, indicating that the source feared Mafia retaliation at the behest of EFCA. Dirks identified his source as a former employee of EFCA, who, while not in the

accounting department, was in a position to know EFCA's business. In response to a suggestion from Zukowski that the source might be trying to short the stock, Dirks indicated his doubt of that likelihood by remarking that his source appeared to him to be a religious man.

After the conversation had gone on about 10 minutes, Courtney came or was called into Zukowski's room, and, after being filled in on the substance of the conversation to that point, Courtney got on the phone with Zukowski. Meanwhile, at some point fairly early in the conversation, Dirk's associate, Allen Gorrelick, joined the conversation on the New York end of the line.

Dirks further related that his source informed him that EFCA had forged 4 or 5 certificates of deposit during one year in order to inflate assets; that insurance policies of $10,000 were put on the books at $25,000 and then co-insured; and that EFCA gave life insurance policies to employees free of first-year premiums as part of the reinsurance fraud.

Among the additional allegations that Dirks related in that conversation was that EFCA's auditors, Haskins & Sells,[13] had dropped the EFCA account.

Some of the participants in that conversation discussed how or whether it would be possible for fraud of the kind being alleged to remain undetected.

Courtney arranged during the phone call to meet with Dirks in New York on the following day, where he was scheduled to be in any event on other business.

After the phone call, Courtney and Zukowski discussed the matter. Zukowski told him of his high regard for Dirks, whom he had known since about 1966 or 1967. Dirks had supplied Zukowski with research reports and recommendations while the latter had been employed at other firms.

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[13] The record indicates that Haskins & Sells audited EFLIC from 1968 to 1971.

Courtney considered the market at that time to be extremely "nervous" and thought that any kind of negative rumors concerning EFCA could seriously undermine the price of its stock. Indeed, he had cautioned Dirks during the telephone conversation that he could "get into trouble" if he spread about wild rumors about EFCA. Courtney was aware that EFCA had a history of price volatility.

Between 6:00 and 6:30 p.m. (EST) Courtney and Zukowski called Haskins & Sells in California, from whom they learned that that firm had been replaced as EFLIC's auditors by Seidman & Seidman, EFCA's auditors.[14] Haskins & Sells had not "dropped" the account. In response to further inquiry from Courtney, Haskins & Sells' representative indicated they had not heard rumors of fraud at EFLIC.

At about 6:30 or 7:00 that evening Courtney told Wise about Dirk's call and that III was "going to unload" EFCA. Since Courtney was to be in New York the following day, Wise undertook to write up the sell tickets the following morning.

At about 7:00 that evening Courtney called Moore, the trader, at his home to tell him of the decision to sell out III's holdings of EFCA in their clients' accounts and to discuss the mechanics of handling such a large sell order. Courtney indicated he wanted the positions in EFCA sold out even if it required a big discount to do so.

On the following day, Tuesday, March 13, Courtney took a telephone call from Wise at Dirk's office in New York City

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[14] The record indicates that Haskins & Sells audited EFLIC from 1968 through 1971, while EFCA and most of its other subsidiaries were audited through 1970 by Wolfson, Weiner, a local auditing firm, and after that by Seidman & Seidman, which had acquired Wolfson, Weiner. The record also shows that in 1972 Seidman & Seidman also took over the auditing of EFLIC; on the EFCA, EFLIC, and related accounts Seidman & Seidman utilized primarily the personnel that had theretofore been engaged in auditing EFCA and most of its subsidiaries for Wolfson, Weiner.

prior to his meeting with Dirks. Wise advised Courtney that Baker, Murphy, and Fuss would not go along with Courtney's proposed sale of EFCA securities for client accounts that he managed. (Late in 1972 III had instituted a so-called veto system, under which a negative vote by any two or more of the portfolio managers would block a proposed buy or sell order.) Courtney was highly displeased with this response and emphatically directed Wise to work on the other managers to get them to sell.

Courtney then met with Dirks and his associate, Allen Gorrelick. Utilizing his notes, Dirks passed on the following fraud allegations and related representations, among others, concerning EFCA as they had been represented to him by his source:

- One-third of EFCA's insurance business was fake "Y" business which Art Lewis had placed on the books of EFCA;
- $10,000 policies were issued and were shown on the books as $25,000 policies which were then co-insured;
- In order to justify the fake business, fictitious records were created to reflect the deaths of policyholders;
- Insurance policies were given to employees free of premiums in order to overstate EFCA's business;
- Lapsed policies were being co-insured;
- In 1970, one-third of the business was fake;
- The fictitious insurance business was handled according to actuarial tables;
- Micky Sultan, head of electronic data processing, Art Lewis and Jim Smith, the actuary and executive vice president, were very involved in the fake business at EFCA;
- Notwithstanding the supposed increase in business, not enough was being done to sustain the number of salespeople;
- Between December 15 and December 31, the books were falsified by doubling the business;

- Ranger National had reinsured $3 to $6 million of the fake business ($1.7 million in 1971). Eighteen different insurance companies had reinsured the fake "Y" business;
- $5 million of EFCA's assets were fake certificates of deposit;
- Dave Capo and Micky Sultan, EFCA accountants, created the $5 million of fake certificates of deposit which were included in EFCA's assets;
- Six people, including Dirk's source, had left the company within the last thirty days because of pressure put on them to sign false statements and to engage in improper accounting;
- EFCA was attempting to bleed Bankers National, and certain people left Bankers National because they had refused to sign its financial statements;
- The source felt his life was in danger;
- The source had left Bankers National three weeks prior to Courtney's meeting with Dirks on March 13, because he would not go along with the EFCA fraud;
- Stanley Goldblum, Fred Levin and Jim Smith thought like crooks;
- Lyle Fisher and Gene Tibide [*sic*; Thibodeau], employees of EFCA, would talk about what was going on at EFCA;
- Lewis and Edens, EFCA's CPA and life insurance accountants, were creating fake assets by falsifying bank statements;
- The accounting firm of Wolfson, Weiner had shown in EFCA's 1971 convention statement assets of $5 million, which, in fact, were fictitious. This fictitious figure amounted to ten per cent of EFCA's total assets;
- Sol Block of Wolfson, Weiner [EFCA's accountants] was being paid off. His bags were packed and he was ready to go to Rio;
- EFCA would instruct employees as to how to respond to confirmation letters sent by outside accountants who were auditing the insurance business, in order to mis-

lead the accountants; for example, on December 20, 1972, a vice president and treasurer had had statements of the funded loan account sent to his home address;

- When an insurance department examined the insurance policy files, they would be given 50 actual files and the conspirators would create another 50 more to support the false policies;
- Art Lewis of EFCA would produce one of four ledgers depending on who would be seeing them, e.g. outside auditors;
- Haskins & Sells dropped the account because they did not like what was going on at EFCA;
- Although Stanley Goldblum said EFCA was a 15 per cent growth company, the actual rate of growth was not close to that;
- EFCA officers were selling EFCA stock all the time. Stanley Goldblum had been selling for the last six months, as was Fred Levin and Edens;
- A co-insurer had rejected a block of policies submitted through Bankers National, which later had to be replaced with high quality good business. This block had been written by EFCA [EFLIC];
- Art Lewis of EFCA was trying to get names of people at Bankers National who had refused to involve that company in the fraud; and
- EFCA was trying to seize control of Bankers National in order to overstate earnings.

Dirks related that his source had said that the insurance business had always enjoyed a reputation for integrity and that that was the key to the insurance business, and it was for this reason that he wanted to expose what was going on at EFCA. Dirks advised that his source had not previously known Dirks but that "some other guy" had referred him to Dirks as an analyst knowledgeable in the insurance business. Courtney concluded Dirks had spent quite a few hours with his source based on the extensive notes Dirks had taken and which he

referred to in the course of his conversation with Courtney. From the conversation Courtney got the impression that Dirks would be visiting EFCA soon and that there would be other people also who would be hearing the fraud allegations as Dirks had relayed them to him.

Dirks asked whether Courtney wanted to meet Dirks's source, but Courtney declined. The Dirks-Gorrelick-Courtney discussion lasted about an hour and a half.

On the morning of March 13 when Courtney met with Dirks and Gorrelick in New York City, at the III offices in Boston Zukowski and Wise related to Baker, Murphy, Fuss, and Moore the gist of what they knew of the Dirks call of the evening before and of Courtney's desires with respect to the EFCA holdings. Zukowski reported that Dirks's source strongly implied the alleged fraudulent practices were still continuing. Zukowski also reported the check with Haskins & Sells.

As already noted, the proposed sale of EFCA securities in client accounts that Courtney managed was vetoed by Baker, Murphy, and Fuss and Wise had telephoned Courtney that information just before Courtney's meeting with Dirks and Gorrelick.

The vetoes were prompted essentially by the belief on the part of those who vetoed that Courtney was acting precipitiously because in their view, as a minimum, III ought first to do some checking into the matter to determine whether the scheme reported by Dirks was even possible, and, secondly, by their concern, first voiced by Baker, that a check should first be made with III's outside legal counsel for an opinion whether the information received from Dirks constituted inside information such as would preclude their selling on the basis of it without proper prior disclosure.

Regarding the second concern, it was agreed that Murphy should call counsel because he, of those available, had had most contact with III's outside counsel. After the general discussion

among the portfolio managers and others was concluded, Murphy obtained additional details from Zukowski concerning the Dirks call of the prior evening in preparation for talking to counsel. Between 10:00 and 11:00 a.m. Murphy called Donald J. Evans, of Goodwin, Procter & Hoar, III's outside counsel.

In a telephone conversation lasting about 15 minutes, Murphy advised Evans that III had received a call from a broker who had been approached by an unidentified and apparently disgruntled ex-employee of EFCA who had left the firm about 3 years earlier and who had alleged that EFCA's earnings had in the past been inflated by the creation of fictitious or bogus insurance policies that were then reinsured or co-insured by other life insurance companies and that earnings had somehow been transferred among EFCA subsidiaries to boost EFCA's reported earnings. Murphy indicated that the ex-employee had been employed by EFCA in 1969 and that he had left in early 1970, and Evans understood that the allegations of wrongdoing all related to that past period and did not involve continuing wrongdoing. The two of them discussed how the bogus insurance scheme could have been made to work from an accounting standpoint to increase EFCA's reported earnings, and neither of them appeared to have a clear conception of the mechanics of how such a scheme would be feasible or could be successfully carried off. Murphy asked two questions: (1) whether III had an inside-information problem and (2) what steps III could properly take to investigate the rumors. On the basis of the data he had been furnished, Evans orally advised that in his view III was not in possession of material, inside information and that III would be free to investigate or examine all publicly available information regarding EFCA. He specifically cautioned Murphy, however, about not contacting the company, EFCA, either directly *or indirectly*, to seek confirmation or denial of the allegations.

Sometime after the results of this consultation with counsel had been conveyed to other portfolio managers by Murphy, Baker in the afternoon of March 13th called Courtney in New York City to advise him that the vetoes of his proposed sales of

EFCA holdings out of accounts managed by Courtney had been withdrawn. Earlier in the day, but after Courtney's meeting with Dirks and Gorrelick, Zukowski had called Courtney, in view of the uncertainties caused by Wise's "insisting" that Moore, the trader, proceed with Courtney's sell orders notwithstanding the vetoes by three portfolio managers, to advise Courtney that the others were still adhering to their vetoes. In response to each of the two calls, Courtney told first Zukowski and later Baker to hold up on his sell orders and that he would take up the whole matter when he returned to the office the next morning. As he testified at the hearing, Courtney had concluded that he didn't want to impose his will on the others and felt he could better bring them around to his view that all EFCA holdings should be liquidated in a face-to-face meeting.

Early in the afternoon of March 13 Zukowski returned Dirks's call of 9:15 a.m. The call lasted 20 to 30 minutes; Gorrelick was also on the line with Dirks. A number of matters were discussed. Dirks reported that he had had a phone conversation with a Mr. Balint, the "head man" at Haskins & Sells, former auditors of EFLIC. Dirks reported he detected a note of concern in the tone of Balint's responses, though not evidenced in anything specific that was said. Dirks also provided Zukowski with EFCA's 1972 earnings figures. In addition, there was fairly extended discussion among the three of them as to whether it would be possible to carry out the purported scheme without having it all collapse like a typical Ponzi scheme. In addition, Dirks mentioned a particular purportedly forged certificate of deposit (he had mentioned there were 4 or 5 such the day before).

On Wednesday, March 14, at the regular meeting of III portfolio managers, attended by Courtney, Zukowski, Murphy, Baker, Fuss and Moore, Courtney took a few mintues at the outset to summarize his discussion of the previous day in New York City with Dirks and Gorrelick.

After Courtney's brief report Baker, Murphy, and Fuss reaffirmed their previous-day withdrawals of their vetoes of Courtney's proposed sales of EFCA securities out of accounts managed by him. At Baker's suggestion, Courtney as president of III called attorney Evans ostensibly to update him and to recheck the legal advice Murphy had been given. In a short (about 5 minutes) telephone conversation Courtney reviewed his understanding of what Murphy had conveyed to Evans and Evans's advice and guidelines. Evans confirmed that that had been his advice based on the information given by Murphy. Courtney offered the view that he didn't think there was an inside-information problem either. Evans reconfirmed his opinion and advice. This was the last conversation Evans had with anyone at III during the relevant period concerning any rumor of fraud at EFCA.

Courtney had not in fact "updated" Evans on the matter at hand. He did not inform Evans of his extended face-to-face meeting with Dirks and Gorrelick the day before or identify the two. Nor, of course, did he convey to Evans any of the substance of that discussion. Neither was Evans told of the March 13 phone call between Zukowski and Dirks, nor any of its content. Additionally, some of the III personnel had on March 13, after receiving Evans's opinion, commenced "checking" the possibilities that the Dirks story could be true with a variety of sources. The fact of these contacts and their results were not conveyed to Evans by Courtney on March 14th or at any later relevant date by anyone as the "checking" process was continued by III personnel.

On March 14th, at Courtney's direction, Zukowski called Dirks to tell him that Dirks's impending trip to Los Angeles to visit the EFCA offices should not be considered to be on behalf of III and to warn him that in III's view Dirks was risking legal liability by spreading the information. Zukowski also advised Dirks of III's check with counsel Evans.

During the morning of March 14 Courtney urged that III liquidate all of its clients' EFCA holdings. Although Dirks had

not told him that he or his source would be talking to others in the investment community about the alleged fraud, Courtney concluded that since Dirks had talked to III he would be talking to others as well and that Dirks's source was probably also disseminating the allegations. The excess of sellers over buyers and the declining price of EFCA stock during the week of March 12th persuaded Courtney that in this posture any rumors or negative uncertainties regarding EFCA would have a heightened adverse impact on the market for its securities. Courtney was gravely concerned that the stock could drop to $10 or lower, given the circumstances and the volatility it had exhibited in the past. He considered that the existence, and probable dissemination, of the Dirks rumor of fraud at EFCA had killed all chance of a rally.

The other portfolio managers, though they had withdrawn their vetoes of Courtney's proposed sales of EFCA holdings in accounts managed by him, were not ready to liquidate. They wanted to continue the process of checking that they had begun on March 13th; for the most part they still entertained beliefs or at least hopes that EFCA stock would rally.

Late in the day on March 14 Courtney directed Moore to proceed with the sale of the EFCA securities in the accounts he managed. On March 15 III sold into the market 36,500 shares of EFCA stock held in such accounts. The shares were sold through Goldman, Sachs to various other brokers and to their customers for proceeds of approximately $942,795. On March 16 III sold $300,000 face amount of EFCA debentures for client accounts managed by Courtney for proceeds of approximately $260,133.

On March 15 Zukowski submitted a Brokerage Request form recommending that III direct $4,000 to $5,000 in commission business to Dirks's firm, Delafield Childs. The reason set forth on the form was "[i]nsurance company reports and recommendations." A commission of $3,956.20 was generated for Delafield Childs pursuant to Zukowski's recommendation.

On March 15 Moore told the III portfolio managers that a trader at Delafield Childs had told him that he understood that

Dirks had talked to a New York bank about the allegations regarding EFCA. On Friday, March 16, Moore advised some of the III portfolio managers that he had heard via the "trader grapevine" that a large New York City bank had been seeking a buyer for a 100,000 share block of EFCA stock. On Monday, March 19, III learned that a 100,000 share block of EFCA traded that day[15] and that EFCA stock had declined in price in heavy trading.

These developments concerned Zukowski and others at III; they indicated to Zukowski that the Dirks-reported information regarding EFCA was spreading via the traders' grapevine and that that could be "deadly." At Zukowski's suggestion, Courtney emphatically urged Murphy, on some of whose accounts Courtney was co-manager, to dispose of the EFCA holdings in his client accounts.

On March 19 Dirks called Zukowski twice, first at about 2:00 p.m. and later at about 6:00 p.m. In the course of these calls Dirks indicated there might be other people, in California, who were aware of the EFCA fraud story, including the acquaintance of Dirks who had referred Dirks's source to Dirks. Dirks also indicated his source had gone to "a large Eastern authority" with the EFCA fraud allegations. He further told Zukowski he would attempt to get his acquaintance in Los Angeles to speak directly on the phone to people at III. In the later call, Dirks indicated he was altering his earlier plan to go to Los Angeles later in the week, cancelling other business (including travel) engagements, and catching the next available plane to Los Angeles to investigate the EFCA matter further. In the course of the two calls Dirks also indicated he expected to visit the EFCA offices and, either in one of those calls or in a call on the following day, Dirks indicated he had a friend who was a reporter in the San Francisco office of the *Wall Street Journal* and that he would inform the *Wall Street Journal* of the EFCA fraud allegations.

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[15] The sale, by Bankers Trust, actually involved only 99,200 shares.

At the morning meeting at III on March 20, Murphy advised the others that he had decided the previous evening, at home, to sell the EFCA securities held in client accounts managed by him. In reaching that conclusion, one of the factors he considered was his awareness that the Dirks story regarding alleged fraud at EFCA was circulating in the investment community, a fact which would make any EFCA rally very unlikely and further price deterioration in the stock very likely. He was also concerned that if Dirks reported to III information gleaned from a visit to EFCA offices, III might be breaching the "guidelines" established by Evans's legal advice. Murphy recommended that Baker and Fuss also sell out their clients, feeling that a block sale was the only equitable way to do it since so many III clients held EFCA securities. But Baker and Fuss were not yet ready to act, so Murphy deferred implementing his decision until the expected call from Dirks from Los Angeles, and that did not occur until after trading had closed.

Dirks called III from Los Angeles at about 3:00 p.m. (EST) on March 20, having taken a "red-eye" flight to Los Angeles the night before. Dirks advised he had spoken with his acquaintance, later identified as Pat Hopper, and that Hopper was willing to talk to III about the EFCA situation. Zukowski and Baker then talked to Hopper on separate telephone extensions. Hopper said he had left EFCA in 1972. He mentioned Ron Secrist as one of those knowledgeable about the EFCA fraud. In the course of the subsequent conversation it became clear to Baker and Zukowski that Secrist was the man whom Hopper had originally referred to Dirks, i.e. that Secrist was Dirks's original source.

The conversation lasted about 45 minutes. While there were various differences in particulars, the information conveyed by Hopper tended broadly to corroborate what Dirks had said his source, Secrist, had told him. What Hopper related did not in the main purport to be based upon first-hand knowledge, but upon what he had been advised by another or others. He did, however, indicate that he had made his own rough study of

insurance policy sales figures from certain branch offices for 1969 and 1970 and had made calculations which indicated to him that the purported annual EFCA sales of insurance were grossly overstated. Baker and Zukowski asked a number of questions, particularly in the area of how co-insurers or re-insurers could be deceived by EFCA. Hopper's response was that the purportedly-available safeguards in the case they were discussing were not adequate to detect phantom insurance. Hopper further indicated that there was another individual at EFCA who was willing to talk about the EFCA fraud even if it meant his going to jail because of his own involvement. Before the close of the conversation, Dirks indicated that this person, subsequently to be identified as Frank Majerus, was the next individual Dirks would be seeing in the course of his investigation.

After some discussion of the Dirks-Hopper call, Fuss and Baker decided to sell the EFCA securities from client accounts they managed the next day, since, as already noted, trading had closed for the day on the 20th.

Late that evening, March 20, at about 10:00 p.m. (EST), Baker received a telephone call at his home from Dirks. Dirks reported he had been successful in interviewing Majerus, whom he identified as a former comptroller of EFLIC. Dirks recounted the description Majerus had provided about how $4-5 million of fake insurance business at EFLIC worked and how it would show up on the books of EFCA and the report by Majerus that bogus certificates of deposit were deposited in a bank. Dirks also confirmed the identity of Ron Secrist as his original source. Baker then telephoned Fuss at home to tell him, among other things, that Dirks had said he was going to confront EFCA management with the allegations of fraud the next day.

At the morning meeting on the following day, March 21, Baker reported to the other portfolio managers the substance of what he had heard in the second call from Dirks on March 20.

Baker, Murphy, and Fuss all indicated they were in agreement that the time had come to liquidate all remaining EFCA securities held in III client accounts. Accordingly, on March 21, a total of 371,500 shares of EFCA were sold through Goldman, Sachs for total proceeds of $7,117,157. In addition, III sold to Goldman, Sachs $575,000 face amount of convertible EFCA debentures for total proceeds of $436,328. In making these sales III did not disclose its information concerning the allegations of fraud at EFCA nor had it done so at the time of its earlier EFCA sales on March 15 and 16. Indeed, Moore, on March 21, in response to a question from the Goldman, Sachs trader, who had noted heavy trading that morning in EFCA securities, as to whether Moore knew anything about EFCA, replied that he did not. Moore justified this negative reply in his own mind on the grounds that (a) he had no first-hand knowledge of the fraud allegations and (b) ever since the first telephone call from Dirks on March 12, Moore had scrupulously avoided passing on to traders with whom he dealt any of the information that was coming in to III about alleged fraud at EFCA because he realized that such rumors would "spread like wildfire" within the investment community and could cause grave damage to EFCA. In his view, he simply adhered to that policy when the EFCA sales out of III accounts were being effected.

Between the time of Dirks's first phone call to III on March 12 and the sale of all EFCA holdings on March 21, the portfolio managers and Wise did a substantial amount of "checking" in an effort to confirm or disprove the allegations of fraud at EFCA that they were hearing. These checks included telephone conversations with a number of insurance companies that co-insured or re-insured EFCA policies, some insurance companies that were not so involved with EFCA,[16] some calls

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[16] Murphy did not contact any insurance companies, and Courtney declined to participate in any further checking after EFCA securities had been sold out of accounts managed by him.

to broker-dealers and analysts familiar with EFCA, and examination and discussion of EFCA filings available at III including a convention statement filed by Bankers National. A particular focus of the inquiry was to determine whether the kind of fraud being alleged was possible or feasible in light of procedures the co-insurers or re-insurers were following and in light of the other entities that would have to be deceived. The results of these checks were mixed and inconclusive, e.g. one re-insurer reported they had a "foolproof" system whereas another described a somewhat "gentlemanly" arrangement under which Wise concluded deception of the re-insurer was possible. While Zukowski, Baker, and Murphy testified that they felt there was no more than a 5% to 10% likelihood that the reports of significant fraud at EFCA were true, the net result of all the checking done by III was that the allegations being related by Dirks could neither be confirmed nor disproved. Meanwhile, Dirks continued to persist in his investigation during the period, to the point of cancelling other engagements and flying out to Los Angeles to interview other former EFCA employees who might confirm or refute the Secrist allegations. Dirks made some 7-10 phone calls in the period to Zukowski and others at III. From his prior association with Dirks, Zukowski knew that Dirks was persistent and highly motivated—once he "sunk his teeth" into something he stuck with it. During this period, III became increasingly aware that the Dirks story about EFCA was getting around and that it was having a sharply negative impact on the market for EFCA stock. Given Dirks's continuing investigation, things could only get worse in terms of the price impact on EFCA stock, absent a conclusive refutation of the rumors, which in the nature of things wasn't likely in the short term.

Subsequent to the sale of EFCA securities by III on March 21, a number of events occurred that bear on the motivation for and circumstances that prompted such sales.

In a telephone conversation with Dirks on the afternoon of March 21, Zukowski told Dirks that III had sold its EFCA client positions and that III would give him $25,000 in commis-

sion business regardless of how the EFCA matter turned out. Courtney and the other portfolio managers had concurred in the proposal and before year's end III directed over $20,000[17] in commission business to Delafield Childs.

Between March 23 and March 26, III personnel discussed with personnel at Respondent Bristol & Co. the nature of the allegations regarding fraud at EFCA and referred them to Dirks. These circumstances are discussed in greater detail below in connection with the discussion regarding Bristol & Co.'s receipt of information concerning the alleged fraud.

On March 29 Courtney discussed the reasons for III's sale of EFCA securities with William Wolbach, president of TBC and director of III. Courtney reported that III had ". . . received disquieting information from the broker concerning potential adverse developments affecting the company." Courtney also reported that he had checked with Don Evans to make sure they had no "insider information" problems and that the information had come ". . . from a broker who received it from 'a fellow who had been *recently* fired by the company." (emphasis added).

In connection with its receipt of information from Dirks and its subsequent sale of clients' EFCA securities, III used or caused to be used the mails and means and instruments and instrumentalities of transportation and communication in interstate commerce and the facilities of a national securities exchange, i.e., long distance telephone lines during conversations with Dirks and others and with Goldman, Sachs, a member firm of the New York Stock Exchange, through which firm the EFCA securities were sold using the facilities of that Exchange.

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[17] See the finding above respecting prior commission business in the amount of $3,956.20 directed [*sic*] to Delafield Childs after the sales of EFCA from Courtney-managed client accounts.

Bristol & Co.

On March 22, 1973, John Bristol was told by a salesman and longtime friend at Goldman, Sachs that an unspecified affiliate of Bristol & Co. had sold a large block of EFCA stock on March 21. The friend felt impelled to tell him this because he was aware that Bristol was in the process of acquiring more EFCA stock for a client.

Having been unsuccessful in reaching either Wolbach or Garrick of TBC on the afternoon of March 22 and again in the morning of March 23, Bristol called Courtney, having surmised correctly that III was the affiliate that had traded the large EFCA block. Courtney stated III had been informed of allegations of phantom insurance at EFCA and had become concerned about the existence of the reports. After a brief conversation, Courtney suggested Bristol talk to Baker, who could better explain the reasons for III's EFCA sales on March 21st. After the call had been turned over to Baker, he talked briefly to Bristol and thereafter to Lee T. Smith, then Bristol & Co.'s president, whom Bristol regarded as more knowledgeable about insurance companies than he (Bristol) was.

In talking to Smith, Baker identified Dirks as the person who had related the allegations to III and said that Dirks had stated his source was a former employee of EFCA. Baker related to Smith the substance of the Dirks-reported allegations, i.e. co-insurance of phantom insurance policies by EFLIC, fabricated certificates of deposit by EFCA, and manipulation of Bankers National earnings statements.

Baker also advised Smith of the substance of the circumstances surrounding III's having gotten an oral legal opinion and guidelines from Evans, and of the "checking" that III personnel had done thereafter.

On March 23 Bristol and Smith discussed the latter's telephone conversation with Baker. They also discussed a memorandum from Oppenheimer & Co. prepared by Donald Kramer that had been received in the morning mail on that day, which reported that an analyst was reporting accounting irregular-

ities at an EFCA subsidiary and that EFCA management had denied any such irregularities. On the afternoon of March 23 Smith called Kramer, who dismissed as untrue the allegations reported by Dirks. Smith also talked to other insurance analysts in an effort to confirm or refute the fraud allegations. Later that afternoon Bristol and Smith called EFCA's executive vice presidents Yura Arkus-Duntov and Fred Levin in New York City, both of whom denied there was any substance to the phantom-insurance rumors.

About the time that Bristol on the morning of Monday, March 26, was in the process of calling a number of advisory clients to obtain their consents to sell their EFCA holdings, Smith received a telephone call from Baker of III, who suggested to Smith that it would be well for Bristol & Co. personnel to speak directly to Dirks in California, as III personnel had done.[18]

Beginning about 9:25 a.m. on March 26th, Bristol and Smith commenced about a 10-minute phone call to Dirks in California, advising Dirks that they were calling at the suggestion of Baker of III. Dirks reported that he had been talking to various former employees of EFCA out in California over the weekend and that "what he had heard was not good." Bristol testified (R. 4932):

> He said if he were in my position he would sell the stock.
>
> He said the publicity was going to get—going to be bad for the company.

Bristol took this to signify that Dirks was adhering to the information concerning fraud at EFCA that he had previously conveyed to representatives of III. Dirks also mentioned he had been discussing the EFCA allegations with a *Wall Street Journal* reporter, and Bristol formed the impression that the

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[18] Baker had been requested to call Smith or Bristol to make that suggestion in the course of the regular morning meeting of portfolio managers at III on March 26.

WSJ would be coming out with an EFCA story that would be unfavorable. Dirks also stated he doubted trading would continue in EFCA stock until the whole matter had been cleared up because he (Dirks) had talked to the former auditors, Haskins & Sells, and had also prevailed upon the former comptroller of EFCA [Majerus], who had talked to Dirks about the alleged fraud, to talk to Haskins & Sells.[19]

Bristol was concerned about the allegations of fraud at EFCA as reported by Dirks and was concerned about the fact that Dirks "was calling people and telling them negative stories about the stock." Bristol knew that Dirks's selective dissemination of the allegations of fraud at EFCA would have a negative effect upon the market for its stock. Bristol became concerned about liquidating clients' holdings of EFCA as soon as possible.

At about 10:00 a.m. on March 26 Bristol & Co. solicited a bid for 457,000 shares of EFCA common stock from Jay Perry, block trader at Salomon Brothers. Bristol accepted Perry's bid of $17½ (less commissions), representing a discount from the market price of $19.[20]

The 600 shares of EFCA common stock owned by the Bristol & Co. Employees' Profit-Sharing Plan were sold through Clark, Dodge & Co. for a total price of $10,399.[21]

Bristol & Co. solicited and accepted Loeb, Rhoades' bid for the block of its clients' EFCA convertible debentures, totaling $200,000 in face amount, at a net price of $149,000.

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[19] Dirks gave Bristol and Smith the phone number of Michael Balint of Haskins & Sells, but Bristol & Co. did not contact Balint or anyone else at Haskins & Sells because of Bristol's concern about coming into possession of inside information.

[20] Subsequently 200 additional shares were discovered in Bristol & Co.'s clients' portfolios and were included in the block bid for by Salomon Brothers.

[21] Bristol made no effort to sell 600 shares of EFCA common owned by members of his family.

The sale of the 600 shares of EFCA common stock from the Bristol & Co. Employees' Profit-Sharing Plan settled in due course with Clark, Dodge & Co.

The sales of Bristol & Co.'s clients' EFCA common shares and convertible debentures did not settle. Salomon Brothers refused delivery of the 457,200 shares, alleging that the transaction was void for violating the anti-fraud provisions of the securities laws. Salomon and its customer, Lawton-General Corp., sought declaratory relief in the United States District Court. Bristol & Co. denied Salomon's allegations and counter-claimed, seeking damages for breach of contract. The Loeb, Rhoades transaction remained open.

Despite Salomon Brothers' refusal to accept delivery of Bristol & Co. clients' shares, the normal on-balance clearing and settlement procedures of the Stock Clearing Corporation resulted in settlement and delivery of some 20,000 shares reflecting Bristol & Co.'s March 26, 1973 trade. The record discloses several ultimate purchasers, including Lily Levy and Walter Rogers.[22]

In acting to liquidate clients' and the Employees Plan's EFCA holdings, Bristol & Co. failed to disclose the Secrist-Dirks information about alleged fraud at EFCA to Salomon Brothers, Loeb, Rhoades or Clark, Dodge.

While engaged in the foregoing acts and practices, Bristol & Co., directly and indirectly, used the means and instruments and instrumentalities of transportation and communication in interstate commerce, chiefly local and long distance telephone lines (to TBC and III in Boston, Dirks in Los Angeles, among others) and used or caused to be used the facilities of a national securities exchange, namely the New York Stock Exchange, through Salomon Brothers, a member firm.

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[22] Official notice is taken of the on-balance clearing procedure, described at Stock Clearing Corporation Rule 8, N.Y.S.E. Guide (CCH) § 3308.

On March 21, after Dreyfus had purchased the EFCA debentures on behalf of DSIF, Orphanos, as the in-house insurance company expert, was called into the Dreyfus trading room by DiMartino, Dreyfus's trader, to discuss by telephone with Eugene Mercy of Goldman, Sachs the reasons for the trading weakness of EFCA securities. Mercy told Orphanos that Dirks had a negative story[23] on EFCA and that Dirks had several reasons for his negative comments. However, Mercy discounted the Dirks story and reported that he, Mercy, had received assurances from Levin, vice president of EFCA, that EFCA management expected to be in contact with Dirks in Los Angeles and was confident they could correct Dirks's "misimpressions."

Thereafter Orphanos called Dirks by telephone and, finding him not in, left word for Dirks to return his call. Dirks did not call back on the 21st.

Either late on March 21 or on March 22 Quinn learned that DSIF had purchased the EFCA debentures. Quinn told DiMartino he did not believe the debentures were a suitable investment for DSIF in the then market environment. Notwithstanding DiMartino's view that the debentures had so declined in price that they afforded a high yield, it was agreed that the debentures should be sold. Accordingly, before anyone at Dreyfus spoke to Dirks, Dreyfus placed an order with Goldman, Sachs to sell the debentures.

On March 22 Orphanos again called Dirks at Delafield Childs; this time he was given a phone number in Los Angeles

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[23] Mercy said that Dirks had issued a "sell recommendation" and that that was the cause of the stock's weakness. However, there is no other evidence in the record that Dirks issued any formal or informal sell recommendation or that, up to that point, he had advised or suggested to anyone that the stock be sold. However, as found above, Dirks later, on March 26, suggested to John Bristol that EFCA stock be sold.

where Dirks could be reached. In a conversation lasting about 30 minutes, Dirks mentioned nonrecurring gains in EFCA earnings and two or three other matters that might reflect adversely on EFCA's management or its future prospects, but none of which involved reports of bogus insurance or forged certificates of deposit.[24]

On March 23 Quinn took a call from Dirks. Dirks initiated this call to Dreyfus because he had ascertained in the interim through Vicker's publication or somehow that Dreyfus clients had EFCA holdings. Dirks now told Quinn that his source, whom he identified as a former employee of EFCA, reported that EFLIC had put hundreds of millions of dollars of bogus insurance representing tens of thousands of fictitious policies on its books, had fraudulently reinsured the bogus insurance, and had issued phony death certificates as part of the scheme. Dirks also advised Quinn that he had passed on this information to five or six institutional investors. Quinn formed the belief that Dirks believed the reports he conveyed regarding EFCA were true.

Quinn called Orphanos at his home and asked him to follow up with Dirks to get further details, and perhaps more understanding, of the alleged fraud in view of Orphanos's greater expertise respecting insurance companies. Quinn and Orphanos agreed to be in touch again over the weekend prior to Quinn's expected arrival in Los Angeles on other business, at which time he would see Dirks.

Quinn then went into the Dreyfus trading room to ascertain whether the sell order placed the previous day for the debentures had been executed or not. Quinn told Di Martino that he had heard some wild allegations about Equity Funding.

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[24] In the context of this proceeding reports of this kind came to be known as the "soft story" in contrast to the "hard story" reports of widespread fraud involving bogus insurance, forged certificates of deposit, and related details.

DiMartino either was on the direct wire to Goldman, Sachs or picked it up and asked Quinn to relate the information to Mercy of Goldman, Sachs. Mercy told Quinn the debentures had not been sold yet, said the market for EFCA was unsettled, and conveyed the impression that the debentures could be sold only at a deep discount.

Quinn conveyed to Mercy the substance of the fraud allegations respecting EFCA that he had heard from Dirks. He did so because he was perplexed and confused by what he had heard from Dirks, was concerned about his clients' EFCA holdings, and hoped that perhaps Mercy, representing a block trader, could shed some light on the subject.

Mercy dismissed the allegations, indicating he was a personal friend of EFCA's vice president Levin, in whose personal honesty and integrity he had great faith. He said he had been aware of "rumors" regarding EFCA and that that accounted for the low price at which Dreyfus had been able to pick up the EFCA debentures on March 21. Mercy, learning that Quinn intended to be in Los Angeles shortly, urged him to check out the rumors personally with EFCA management.

Quinn decided against selling the debentures at a discount, suspended the sell order, and decided to suspend judgment pending further checking by Dreyfus, including his impending business trip to Los Angeles at which time he would talk in person to Dirks and possibly visit EFCA management.

Shortly thereafter Quinn received a call from Levin, who happened to be in New York City on March 23, and Arkus-Duntov from EFCA's New York office. They stated they understood Quinn had heard some rumors regarding EFCA. Quinn related the substance of what he had heard from Dirks. Levin dismissed the allegations as preposterous and presented arguments to the effect that it would be impossible for such things to occur undetected.

During the afternoon of March 23, Orphanos conversed by phone with Dirks concerning the allegations of fraud at EFCA.

Included in what was conveyed to Orphanos were allegations that one third of all insurance in force at EFLIC was fictitious and that Don Goff, a current employee of EFCA, had confirmed the fraud.

In a subsequent phone conversation the next day, March 24, a Saturday, Orphanos got from Dirks the names and positions of various persons with whom Dirks had spoken in the course of his continuing investigation, including the names and phone numbers of at least four former EFCA or EFLIC employees: Secrist, Hopper, Gene Thibodeau, and Brian Tickler. Dirks also indicated he planned to speak shortly to Michael Balint of Haskins & Sells, EFLIC's former auditors, and that he doubted EFCA would open for trading thereafter.

Over the March 24-25 weekend Orphanos spoke by telephone with Secrist for 44 minutes and more briefly with Thibodeau and Tickler. Secrist talked freely, confirming in general the story as Dirks had given it and adding some particularizing detail. Thibodeau spoke, among other things, of special computer tapes accessible only to top EFCA officers, of "Departments 99 and 65" (code terms for the alleged phony insurance operation), and of 20,000 policies that generated neither bills nor routine correspondence. Tickler showed a reluctance to talk about particulars over the phone but implied that there was a great deal going on at EFCA that wasn't right.

In phone conversations on March 24-25 Orphanos conveyed to Quinn the gist of what he had heard from Secrist, Thibodeau and Tickler, and added his own impression that something was seriously wrong at EFCA. Quinn instructed Orphanos to brief Peter Vlachos, who would be the only Dreyfus portfolio official present at the New York offices on Monday, March 26, empowered to authorize a sale. Orphanos did so. Quinn and Orphanos also arranged on the 25th to speak again on the morning of the 26th, by which time Quinn would have met with Dirks.

Dirks and Quinn met on the evening of March 25 in the latter's hotel room, for about 15 minutes. Dirks carried a satchel of papers, including copious notes of the interviews he

had conducted. He told Quinn that he had contacted additional employees or former employees of EFCA since their last conversation and that they had corroborated information he had gotten earlier. Dirks stated he had begun to fear for his personal safety to the point that he moved to a different hotel after having been advised to be cautious by a representative of EFLIC's former auditors. Dirks indicated to Quinn his understanding that an "unfunded receivables" account was a key element in disguising EFCA's asset shortages.

Dirks reported to Quinn that he had arranged for Majerus and Hopper to meet with William Blundell, a *Wall Street Journal* reporter to whom Dirks had told his EFCA story. Dirks also told Quinn that he had requested Majerus, the former comptroller at EFLIC, to tell his story to a Mr. Balint, the partner in charge at Haskins & Sells, EFLIC's former auditors. Dirks also said he had subsequently learned from Balint that Majerus had called him. Dirks told Quinn that he regarded this as significant because Balint knew Majerus well and that this might prompt Haskins & Sells to "do something".

By the conclusion of his meeting with Dirks, Quinn realized that the story about fraud at EFCA had been "embellished" (i.e. elaborated), and he felt that "the web was spreading." Orphanos, his in-house expert, was crediting the information. Quinn's testimony that he did not believe "totally" in Dirks indicates that at the very least he believed at that point that there was a good chance that the Dirks allegations, as reported by him and "confirmed", in substance, by others, were true.

Early on Monday, March 26, before the market opened, Orphanos and Vlachos called Quinn. Quinn indicated he had seen a large amount of paperwork by Dirks, and that nothing he saw or heard was inconsistent with what Quinn had originally heard from Dirks about fraud at EFCA. Quinn wanted the debenture sell order re-entered. Based on the briefings by Quinn and, earlier, Orphanos, Vlachos concurred and agreed to authorize the sale of the debentures. Having been unable to disprove the allegations of fraud at EFCA after extensive

checking (to the contrary, all the checking results were consistent with and therefore tended to corroborate the allegations), Dreyfus personnel concluded that they should act on the information they had received about fraud at EFCA by selling the debentures. As Orphanos put it (R. 476):

> Sale of the security is . . . if you can't satisfy your doubts completely, is a normal investment conclusion.

Quinn indicated to Vlachos his view that their boss, Howard Stein, then away in Europe, should be advised of the EFCA matter, particularly in light of the EFCA common stock holdings in the DF account.

Shortly after speaking with Quinn, Vlachos reactivated Dreyfus's sell order for DSIF's $500,000 face amount of EFCA convertible debentures without substantive discussion of EFCA with anyone at Goldman, Sachs. Goldman, Sachs, acting as principal, purchased the debentures for net proceeds of approximately $362,933.

In effecting its sale of the EFCA debentures on March 26, 1973, Dreyfus personnel acting on behalf of DSIF used or caused to be used the mails and telephone. The telephone was also used in conversations with Dirks and others and among Dreyfus personnel.

Manning & Napier

On March 21, 1973, Manning telephoned Oppenheimer & Co., a broker-dealer with which Manning & Napier ("M & N") had in the past transacted some business, seeking information concerning EFCA. He first spoke to Neil Weisman, with whom he had had contacts before. Weisman told Manning there was a rumor out concerning EFCA and referred him to Donald Kramer, an insurance analyst and partner at Oppenheimer & Co., who, Weisman indicated, was more knowledgeable about the matter.

Either Weisman or Kramer identified Dirks as the source of the rumor regarding EFCA, and indicated Dirks's employer was Delafield Childs.

Kramer told Manning that the rumor involved questionable accounting practices but that he placed no credence in the rumor. Manning testified that Kramer told him on March 21 that the rumor involved allegations of bogus insurance policies and of a change in accountants at EFCA. The testimony by Manning about having been told of bogus insurance at EFCA is not credited, for a number of reasons. Firstly, in testifying at the hearing Manning exhibited considerable uncertainty as to what was said in his first conversation with Kramer, on March 21, as contrasted with what was said in his second telephone conversation with Kramer, on March 26, after Manning had spoken on the phone with Dirks. Secondly, Kramer testified positively and persuasively that he did not mention on the 21st anything to Manning about bogus or fictitious insurance policies at EFCA and that in fact he had as of that date not heard any such rumor. Thirdly, there is no other evidence establishing that Kramer on the 21st was aware that the rumor regarding EFCA involved bogus insurance. Lastly, in a memorandum dated March 21, 1973, Kramer, in referring to and discounting a rumor regarding EFCA, stated that "— a small brokerage firm following Equity Funding's stock questioned the accounting. Management has denied that there are any accounting changes."

After his conversations with Weisman and Kramer on March 21, Manning attempted to reach Dirks; he was told by Delafield Childs personnel that Dirks was not in but would return the call.

During "pub night" on Friday, March 23, Manning told Reeves that he was "getting out" of Equity Funding.

Dirks did not return Manning's call until the morning of Monday, March 26, when he called from Los Angeles. The call lasted about 35 minutes. Manning indicated to Dirks that they had a position in EFCA and had heard that Dirks had some information regarding EFCA. Dirks told him that EFCA had written bogus insurance policies and that the source of this information was a former EFCA employee who had been in a position to know of the fraud. Dirks also gave Manning the

impression that he was continuing to investigate the allegations. In addition, Dirks reported that top management at EFCA was reportedly involved in the bogus insurance fraud. This is clear from Manning's testimony that during his later call to Kramer, also on March 26, during which Manning was trying to get Kramer's reactions to what Dirks had reported, Kramer expressed the strong conviction that top management at EFCA could not be involved in any such scheme.

Beyond that it is not clear what if any additional information Dirks gave Manning about the fraud at EFCA as he then understood it to be during their 35-minute phone conversation. While it seems likely that Dirks gave additional details in the course of a conversation of that length, given the disposition of Dirks to speak freely about his investigation to anyone he knew had holdings in or "an interest in" EFCA, this is not established by "clear and convincing" evidence and accordingly no finding is made on this point.

On the morning of March 26, after his call to Dirks, Manning called Kramer. In this second conversation, according to Manning, he related to Kramer the gist of what he had learned from Dirks. Kramer adhered to his views that EFCA was all right, and, as noted above, expressed strongly the view that top management at EFCA could not be involved in fraud.

On March 26, directly after Manning had talked to Dirks and then Kramer, M & N liquidated all EFCA securities in its client accounts (5,450 shares of EFCA common stock for net proceeds of $89,952) between noon and 1:00 p.m.

That Manning acted with unusual dispatch in selling EFCA holdings following his two phone conversations is evident from the fact that he had a clerical employee who did not customarily execute securities transactions make the sales rather than awaiting the return at 1:00 p.m. from lunch of his assistant Calvert,[25] who normally executed securities transactions for the firm.

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[25] The two employees had switched their lunch hours that day.

At the time he directed sale of the EFCA stock, Manning was convinced that selective dissemination of the Dirks story regarding EFCA was driving the price of the stock down. (R. 3566). This, in turn, made Manning more disposed to credit the allegations of fraud at EFCA as conveyed by Dirks. In prior sworn testimony given before an SEC investigating attorney on January 25, 1974, Manning testified in part as follows (R. 3559-60):

> I just have to say that if the market conditions were different, possibly if I didn't have the attitude that I did, that I might have ignored him. [Dirks]
>
> * * *
>
> But the stock had come down to the point where I was panicky about it.
>
> It was dropping rapidly.
>
> . . . I was emotional at that time and I was disturbed by the price and confused by what a couple of so-called experts were giving me on both sides of the story.

When the EFCA stock was sold by M & N the information Manning had obtained from Dirks was not communicated to the brokers with whom the sell orders were placed. Nor was there any communication to them of the substance of Manning's conversations with Kramer.

In connection with the sales of its clients' EFCA holdings, M & N used or caused to be used the mails and means and instruments and instrumentalities of transportation and communication in interstate commerce and the facilities of a national securities exchange. M & N used the telephone in seeking and receiving the Dirks information about EFCA and in connection with Manning's conversations with Kramer.

Tomlin, Zimmerman & Parmelee, Inc.

In March, 1973, TZP maintained direct, open telephone lines to a number of broker-dealers with whom it did substantial business, including Goldman, Sachs & Company.

During the week of March 12 Edward Spiegel, a registered representative at Goldman, Sachs, who serviced the TZP account, called Tomlin to advise him that Goldman, Sachs had traded a large block of EFCA stock at a sharp discount. He said he didn't know why, but would attempt to find out. On Friday, March 16, and again on Monday, March 19, Spiegel told Tomlin he had not learned anything.

On March 20 Spiegel called Tomlin and Zimmerman to relate that he had heard "third or fourth hand" that Dirks had a negative story about EFCA. Spiegel did not state the substance of the story, and there is nothing in the record to indicate whether he was aware of it. Thereafter, Zimmerman placed a call to Delafield Childs on March 20th, where he learned from an associate of Dirks, Allen Gorrelick, that Dirks was not in the office but would be calling in.

That same day Dirks returned Zimmerman's call and talked to Tomlin and Zimmerman for about 20 to 30 minutes. Tomlin remained on the phone during the entire conversation and Zimmerman was on the phone for parts of it. In the course of the conversation it became clear that Dirks was calling from California.

During this conversation Dirks indicated that he had questions about a possible change in accounting for dividends to participating policyholders at Bankers National which could have inflated EFCA's 1972 earnings. Dirks also reported that a number of executive employees had left Bankers National recently, to which Tomlin responded that this was well known and was not unexpected when there is an acquisition. The Bankers National convention statement and EFCA's financial statements generally were discussed in this conversation. Tomlin was favorably disposed towards EFCA and attempted to point out positive things about the company.

There was no mention of fictitious insurance or of fraud at EFCA or any of its subsidiaries in the course of this conversation.

Dirks indicated he would be meeting with EFCA management personnel and asked if Tomlin or Zimmerman had any questions they wanted him to explore. One or the other suggested that Dirks attempt to get clarification of the Bankers National "numbers."

Following this conversation and prior to their next conversation with Dirks, on March 22, Tomlin called Don Kramer at Oppenheimer & Co., Edus Warren at Spencer Trask and a Mr. Jones at Edwards & Hanley, and received confirming views that there was nothing wrong with EFCA's accounting and that the stock was a good investment. Prior to March 20, Tomlin had spoken to Edward MacElaney at Conning & Co., who also favored EFCA.

On March 22 Dirks left a message requesting that Tomlin or Zimmerman return his call, which they did at 3:32 p.m. (EST). Tomlin participated during the entire 39-minute conversation that ensued, whereas Zimmerman was intermittently off the phone.

Dirks reported that he had met with EFCA management and discussed the Bankers National convention statement and Bankers National dividends to participating policyholders. Dirks indicated he was not entirely satisfied with management's explanation of the accounting for dividends to participating policyholders nor sure that he could believe their explanations.

Dirks also said that EFCA was issuing insurance policies to employees free of first-year premiums. Dirks testified that this part of the conversation involved policies issued by EFLIC, whereas Tomlin and Zimmerman testified that they understood Bankers National to be the subsidiary involved. Tomlin attempted to explain to Dirks that this would not be an abnormal practice based upon his understanding that it was not uncommon in the insurance industry for companies to offer insurance to their employees at a first-year premium that represented the normal first-year premium less what was paid to salesmen the first year and that, since EFCA had a first-

year commission to salesmen of 100%, that meant there would be no premium charge to the employee in the first year.

There was also discussion during this conversation in general terms of the value of EFCA as a holding. Tomlin referred to a favorable analysis by Conning & Co. and said EFCA's financial statements showed good insurance sales and earnings.

Either during the conversation on the 20th or the 22nd, Dirks indicated he had been talking to a former employee of Bankers National who had been fired, and Zimmerman testified he understood the former employee to be the source of some of the "rumors" Dirks was conveying.

During the March 22 conversation there was no mention of fraud at EFCA or any of its subsidiaries.

By the time the March 22 conversation with Dirks had occurred, Zimmerman had concluded in his own mind that what Dirks had told TZP he was also telling others.

On the morning of March 23 Charles Boillod, a salesman at Goldman, Sachs, telephoned Zimmerman and told him that they were in the process of assembling a sizeable block trade of EFCA and expected to trade about 100,000 shares on an "uptick". Boillod said there was considerable interest in the stock, that they felt its price was bottoming out, and that the projected block trade would pretty much "wash out" the stock, meaning that after a substantial decline in a short period of time in an oversold stock a large trade such as that contemplated could be expected to relieve the selling pressure and afford a favorable environment for a return to higher price levels.

After discussing the call from Boillod, Tomlin and Zimmerman on March 23 purchased 3,000 shares of EFCA at $19¾ as part of a block traded by Goldman, Sachs as agent for both sides. As part of that decision to buy, Tomlin and Zimmerman concluded that the price of the stock was favorable, that the drop in price had been caused in part by the activities of Dirks, and that their conversations with Dirks on March 20 and 22 had

served to correct Dirks's "misimpressions" concerning EFCA, so that they could reasonably expect him not to spread any more negative rumors about the stock.

Later in the day on March 23, a Friday, Dirks left a message for Tomlin or Zimmerman to return his call. Tomlin did not return to the office that Friday afternoon, and Zimmerman chose not to return the call.

On Monday, March 26, prior to 10:00 a.m. (EST), Dirks again phoned TZP from Los Angeles, though his call of the previous Friday had not been returned.

Zimmerman took the call and promptly called Tomlin to the phones as well. A sixteen minute conversation among the three men followed.

Dirks told Tomlin and Zimmerman that his source told him there was fictitious insurance on the books of an EFCA insurance subsidiary. Tomlin and Zimmerman testified that the subsidiary referred to was Bankers National; Dirks's testimony, on the other hand, in its overall context, would have to be taken as referring to EFLIC. It is concluded that while Dirks referred to EFLIC, Tomlin and Zimmerman mistakenly understood the reference to be to Bankers National, perhaps because much of their earlier two discussions had focussed on Bankers National and because Dirks's source for this allegation was identified as a former employee of Bankers National.

Tomlin demanded to know who the source was for this new rumor. Dirks, without identifying him by name, stated that his source was a former employee[25] of Bankers National who had been fired.

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[25] There is evidence in the record that would warrant a conclusion, if the standard of proof being applied were that of "preponderance of the evidence" rather than the "clear and convincing" test, that Dirks identified his sources as former employ*ees* of EFCA. Likewise, there is evidence in the record that would warrant a conclusion, under the less demanding standard of proof, that Dirks told Tomlin and Zimmerman on March 26 not only the allegations of fictitious insurance

Tomlin testified that the amount of reported fictitious insurance was $7,000,000 on the books in 1971. Zimmerman testified to the same figure but was not sure of what year it applied to. Dirks did not refer to a specific figure, but if he had mentioned any figure it would have been about a third of the policies of EFLIC.[27] It is concluded that somehow Tomlin and Zimmerman erroneously came to understand that the amount of fictitious insurance involved was $7,000,000 face amount.

When Tomlin asked Dirks if he believed allegations of fictitious insurance, he stated that "he might." He stated this view even after he had earlier, as he reported to Tomlin and Zimmerman, confronted EFCA's president Goldblum with the allegations of fraud. Goldblum had flatly denied the allegations and had asked whether Dirks was charging that EFCA was committing fraud. Dirks reported that he had stated to Goldblum that he was not alleging fraud.

Dirks also reported in his March 26 conversation that he had reported the allegation of fictitious insurance to Haskins & Sells, EFLIC's former auditors.

Dirks further reported that he had informed EFCA's [and EFLIC's] current auditors, Seidman & Seidman, of the allegation regarding fictitious insurance and had given them a copy of some notes he had taken relative to the matter. Dirks reported that he became very upset when he learned shortly after

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but also in substance the story about fictitious assets and fake death certificates etc., that officers of EFCA were reportedly involved in the fraud, and, in short, the allegations that he, Dirks, was aware of at that time. (R. 1155). Dirks testified that his testimony at p. 1155 of the transcript represented, in substance, his best recollection of what he told TZP on March 26th. (R. 1917). Later, on recross (R. 1929-31) Dirks testified that in certain particulars his testimony as reported at p. 1155 of the transcript was based upon his ". . . hypothesis in trying to figure out what I would have said at that time and not based on recollection, specific recollection." The findings made herein, are only those that meet the "clear and convincing" standard.

[27] See footnote 26 next above.

turning over the notes that Seidman & Seidman had promptly turned over the notes to Goldblum.

Zimmerman testified that some of the time in the conversation on March 26 was spent going over the ground covered in their earlier conversations on March 20 and 22. Tomlin, on the other hand, testified that they did not go over what had previously been covered, nor does Dirks's testimony give any such indication. It is concluded that no significant amount of the March 26 conversation was devoted to reviewing matters covered during the earlier two calls.

Immediately after discussing the implications of their March 26 conversation, Tomlin and Zimmerman decided to sell all EFCA securities held in TZP client accounts.

They were both upset about hearing the fraud allegations from Dirks. Tomlin tended to disbelieve the allegations of fraud and suspected that a bear raid might be in progress. Zimmerman, who had formerly worked at another firm while Dirks was also employed there, felt that Dirks was determined to destroy the stock and that they couldn't tell what kind of a rumor regarding EFCA Dirks would be coming out with next, though he did not attribute any ulterior motives to Dirks's activities.

Tomlin and Zimmerman concluded that Dirks would disseminate the allegation of fictitious insurance to others and that it would get around, and they were concerned about this. They had already concluded that even the "soft story" rumors reported earlier by Dirks had been a factor in depressing the stock of EFCA. They concluded that the further dissemination of the allegations of fictitious insurance at EFCA could only be negative, not positive. They despaired of any hope that the stock would recover—a hope they entertained on the 23rd when they purchased 3,000 additional shares of EFCA. Their concern was heightened by the fact that they were aware that in the past EFCA had reacted strongly to an unfavorable report.

Through March 26 Tomlin and Zimmerman had not heard any report of fictitious insurance at EFCA or any of its subsidiaries from any source other than Dirks.

Prior to the lunch hour on March 26 Zimmerman placed sell orders for all of the EFCA securities held by TZP's clients. These included 26,920 shares of common stock and $60,000 face amount of debentures. 24,500 shares of the stock and all of the debentures were sold through Goldman, Sachs, 200 shares of stock were sold through Stern, Frank and 220 shares through Loeb, Rhoades.

At the time of TZP's sales on March 26, Tomlin and Zimmerman had no knowledge of whether Goldman, Sachs or the other brokers knew of Dirks's report of allegations of fictitious insurance at EFCA.

Before the sale of the EFCA securities held by TZP's clients neither Tomlin nor Zimmerman told any Goldman, Sachs or Stern, Frank or Loeb, Rhoades representative about Dirks's report of allegations of fictitious insurance at EFCA.

After the March 20 and 22 conversations with Dirks, Tomlin had informed Spiegel at Goldman, Sachs of the substance of the conversations; but on March 26 Tomlin made no call to Spiegel, prior to TZP's sales of EFCA securities, even though Spiegel had been the source of TZP's initial information that Dirks had some negative information concerning EFCA.

In connection with the sales of its clients' EFCA holdings, TZP used or caused to be used the mails and means and instruments and instrumentalities of transportation and communication in interstate commerce and the facilities of a national securities exchange.

Raymond L. Dirks

In addition to the findings made above in this part regarding the receipt, investigation, and dissemination of non-public information concerning fraud at Equity Funding by Respondent Raymond L. Dirks in connection with findings made respect-

ing the individual selling respondents,[28] certain additional findings are necessary with respect to Respondent Dirks as bearing on the charges against him.[29]

On March 6, 1973, from "out of the blue" Dirks received a telephone call from Ronald Secrist, who introduced himself as a friend of Patrick Hopper, whom Dirks knew. Secrist further identified himself as a former employee of EFCA or EFLIC and of Bankers National, and said he had some significant information about his former employer that he thought would interest Dirks, e.g. that one-third of EFCA's reported life insurance did not exist, that fake certificates of deposit had been created, and "other sorts of activities that would indicate the Company was doing some mighty unusual things." Dirks agreed to meet with Secrist the next day around noon.

On March 7 Dirks and his associate, Allen Gorrelick, met over lunch with Secrist for about 3½ hours. In substance, the main allegations conveyed by Secrist relevant here were those subsequently reported by Dirks and Gorrelick to III personnel, as found above.

Dirks took extensive notes during the conversation.

Secrist described the origin of the alleged fictitious insurance scheme. He said he understood that when Presidential Life, the predecessor of EFLIC, was acquired Presidential had poor-quality business on its books. Because Fred Levin had managed to reinsure the business at a good price, he was made President of EFLIC. The next year EFCA decided to give its employees insurance without a first-year premium.

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[28] Dirks himself did not sell any EFCA securities; the other respondents are sometimes referred to collectively as the "selling respondents". Dirks is charged with having aided and abetted selling respondents in their alleged violations and with having committed violations independently through his alleged "tipping" activities.

[29] See footnote 28 next above.

This created a large block of insurance that was subsequently reinsured. In 1970, Secrist continued, EFCA at Levin's suggestion embarked on a full-fledged program of totally fictitious insurance in order to sustain EFCA's objectives of 15% compounded growth rate in net earnings. This business, Secrist stated, became the "Y" business, so named by Art Lewis, the EFLIC chief accountant and statistician, because in mathematics "Y" is a symbol for an unknown.

Secrist said he had been told that 1/3 of EFLIC's insurance in force—40,000 policies—was fake and that each of 18 companies with which EFCA reinsured had some of the phony "Y" business.

There was considerable discussion as to how there could be a failure to discover the alleged scheme on the part of the companies reinsuring the fake EFLIC policies. Secrist attributed this to lax procedures on the part of the co-insurers and a tendency to rely too heavily on trust in the insurance industry.

Likewise, there was discussed the question of how the auditors could fail to discover such a scheme. Secrist said that although EFCA had been regularly audited, the audits had not uncovered the alleged fraud. Secrist stated he had been told that the company created fake policy files and that he personally had on one occasion participated in a "party" creating such files. Secrist also stated his understanding that EFCA supplied the auditors with phony confirmation letters from purported policyholders. Secrist exhibited to Dirks and Gorrelick two examples of such confirmation letters, bearing the names of "Crist" and Secret.

Secrist stated he understood that when necessary as many as 20 phony files would be created overnight, after the auditors had indicated what files they wanted to check, and that these would be complete with medical records and other supporting items.

Secrist also reported his understanding that in order to support the fraud it was necessary to create other phony journals, ledgers, and records and that this included the crea-

tion of fictitious bank statements and forged certificates of deposit.

Secrist also told Dirks and Gorrelick he had heard that Sol Block, a C.P.A. with Wolfson, Weiner, the subsidiary of Seidman and Seidman that performed the EFCA [including EFLIC] audits, was actually on the payroll of EFCA and that Block had been "paid off" at the end of 1971.

As to Haskins & Sells, EFLIC's former auditors, Secrist stated he understood that they had been fooled by a number of stratagems employed by Art Lewis and others but that, by the end of the third year of the scheme, they had become very suspicious of EFLIC.

Secrist told Dirks and Gorrelick that he had been told that some people at EFCA had heard of Mafia threats and were inhibited from discussing the fraud.

Secrist told Dirks and Gorrelick that Brian Tickler, a data processing consultant to EFLIC, confirmed the fraud to him. At Dirks's request, Secrist named Lyle Fisher and Gene Thibodeau, who had left the company, as possible further contacts for Dirks. Later in the conversation Secrist gave Dirks additional names of former employees that he said could confirm the fraud and would talk to Dirks: Frank Majerus, Don Goff, Mike Keller, and Pat Hopper.

Secrist also reported that there were stories around the company that the top officers kept a supply of ready cash on hand along with their passports and that they kept their suitcases packed so as to be able to leave the country on a moment's notice "in case this thing blew up."

A considerable part of the conversation involved alleged activities or events or occurrences at or respecting Bankers National, where Secrist had been transferred from EFCA/EFLIC in October, 1971, and to which a number of other EFCA/EFLIC employees had also been transferred. However, those matters are essentially irrelevant to the issues presented in this proceeding. Secrist indicated that while at

Bankers National he had continued to discuss "Y business" and related matters at EFCA/EFLIC with employees at Bankers and others.

The interview included the question of Secrist's motivation in coming to Dirks with his story. Secrist asked Dirks to check the information, verify its accuracy, and then disseminate it as widely and quickly as possible. In response to a question from Dirks as to whether Secrist had sold EFCA stock short, Secrist replied that although a friend had suggested that to him he had rejected the proposal out of hand. Secrist said he felt strongly about the reputation of the insurance industry, which he considered to be basically ethical, and he said he thought fraud of this kind had to be exposed.

Dirks asked Secrist for permission to discuss the EFCA fraud allegations with Herbert Lawson, Chief of the San Francisco Bureau of the *Wall Street Journal*, and Secrist consented.

Secrist indicated he had not gone to the SEC with his allegations about fraud at EFCA because of his understanding that other employees who had done that in this or similar situations had not met with success and had had the confidentiality of their reports breached.

With respect to state departments of insurance, Secrist indicated to Dirks and Gorrelick that Fred Levin of EFCA had formerly worked at the Illinois Insurance Department, that he had heard someone there had been paid off by EFCA, and that, based on what he understood to have been a lack of interest in prior reports of irregularities by others, he had not gone to any state regulatory bodies with his allegations.

After concluding the meeting with Secrist and Gorrelick on the 7th, Dirks left for Philadelphia where he had business appointments and where he remained Thursday and part of Friday, March 8 and 9. Before leaving, he requested Gorrelick to check out with Ron Kehrli, a friend of Gorrelick's who had been with EFCA, the possibility that some confirmation of the

fraud could be obtained, as Secrist had suggested, by examination of the sales records of the 200 most productive EFCA salesmen.

Returning to New York City on Friday the 9th, Dirks obtained from his files the convention statements of Bankers National and EFLIC as well as other reports and the most recent prospectus issued by EFCA. He examined these materials over the weekend of March 10 and 11. He found nothing in them that would tend either to confirm or to disprove Secrist's allegations of fraud at EFCA.

Either on Friday, March 9, or Monday, March 12, Gorrelick, acting on Dirks's instructions, called individuals at Bankers National in an attempt to test the Secrist allegations, particularly as the related to alleged events at Bankers National.

On the morning of March 12, a Monday, Dirks attempted to call Herbert Lawson of the *Wall Street Journal*. Dirks's purpose, as he testified (R. 1249) was as follows:

> Well, I thought that I would try to have somebody who could generate publicity about this investigation it [*sic*]—investigate with me or separately and I wanted to give him the allegations by Mr. Secrist in order that he could do something.

Lawson was not available and it was not until later that Dirks made contact with him.

On the morning of Monday, March 12, Dirks also had a telephone conversation with EFCA's president, Goldblum, using as a pretext for calling the appearance that morning of the EFCA earnings report on the Dow Jones broad tape. The two discussed EFCA's fully diluted earnings, including earnings of EFLIC and Bankers National, which Goldblum reported were up, as well as the number of EFCA's sales agents, but the allegations Dirks had heard from Secrist were not raised. Goldblum invited Dirks to visit EFCA's offices, and they made an appointment for him to do so about March 27-28.

On March 12 Dirks directed his staff to examine Delafield Childs's records to ascertain which clients or potiential clients

"had an interest" in EFCA. "Having an interest" in a stock was something of a euphemism that clients and analysts employed because of a reluctance on the part of clients or potential clients to disclose specifically whether they held a stock or the extent of their holdings. Nevertheless, based on the nature of the contacts, it was frequently possible for an analyst to surmise that a client or contact held or at least likely held a stock and to have some idea of the probable size of any such holding. Based upon examination of the contact sheets and upon Dirks's specific recollection of an earlier conversation with Zukowski of III, III, Institutional Capital, and the Employee Pension and Profit Sharing Plan of Sears Roebuck were identified as likely holders of EFCA securities.

Later in the day on March 12, Dirks called Zukowski and there ensued the 40-45 minute conversation among Dirks and his associate Gorrelick in New York and Zukowski and Courtney of III in Boston, during which the former conveyed to the latter essential elements of the Secrist allegations of fraud at EFCA, as found above.

After his conversation with III officials on March 12, Dirks called Haskins & Sells, EFLIC's former auditors, and spoke with Michael Balint, who had been in charge of the EFLIC account. As Dirks reported to III the following day, he detected a note of concern in Balint's reaction to Dirks's call, as found above.

On Tuesday morning, March 13, Dirks and Gorrelick had their meeting with III's president, Courtney, at the Delafield Childs offices in New York, as found above. Dirks "surmised" that III had a substantial position in EFCA based on Courtney's willingness to visit Dirks and Gorrelick at the Delafield Childs offices.

Additional telephone conversations concerning alleged fraud at EFCA occurred on the afternoon of March 13 and on March 14 between Dirks and Zukowski, as found above.

On the afternoon of March 14, Gorrelick advised Dirks that John Buszin, a security analyst at Bankers Trust Company

specializing in the insurance industry, had told him that Bankers Trust owned EFCA securities, and raised the question with Dirks whether they shouldn't convey to Bankers Trust the same information they had conveyed to III regarding allegations of fraud at EFCA. Dirks concluded they should call Buszin, who confirmed that Bankers Trust held EFCA securities and indicated he would like to hear anything Dirks might have to report about EFCA. Dirks concluded he'd rather convey the information in person and therefore arranged to call at Buszin's offices, only a few blocks away, the following day, March 15.

Dirks met as scheduled with Buszin on March 15, and related briefly the central allegations of fraud at EFCA that he had heard from Secrist. After a time Buszin indicated he didn't care to hear any more and that Bankers Trust was going to sell their EFCA holdings. Dirks was "shocked" to hear Buszin announce that intention so abruptly because in his experience such decisions were normally made much more deliberately.

On Monday, March 19, Dirks called Pat Hopper, a former EFCA employee, after having made a prior unsuccessful attempt to locate him in Los Angeles. Dirks sounded out Hopper about the allegations of fraud at EFCA that he had heard from Secrist. Hopper indicated that while he personally had no evidence of fraud at EFCA, he was inclined to give a certain degree of credence to Secrist's allegations.

While he was on the phone with Hopper, Dirks learned that a block of 100,000 EFCA shares traded that day. In light of Buszin's statements on March 15, Dirks concluded the seller was probably Bankers Trust, and he conveyed that belief to Hopper.

On the 19th Dirks also called Secrist. He told him of his conversation with Hopper. In the course of this conversation Dirks learned for the first time that Secrist had reported his allegations to a state insurance department on the East Coast.

In addition, on March 19 Dirks had two more telephone conversations with Zukowski of III, concerning, among other things, Dirks's impending trip to Los Angeles, as found above.

On March 19 Dirks again called Lawson of the *Wall Street Journal* in San Francisco, Lawson having failed to return Dirks's earlier call. Dirks told Lawson that a former employee of EFCA had alleged that senior officials of EFCA were involved in fraud that included fictitious insurance, death certificates, certificates of deposits and other assets. Lawson responded that the matter might be turned over to their Los Angeles office. (Under established *WSJ* procedures, that "story", as William Blundell of the *Journal* testified, belonged to their Los Angeles office inasmuch as EFCA was located there.) Dirks expected that a highly respected publication like the *Wall Street Journal* could be effective in helping him investigate the Secrist allegations and to expose the EFCA fraud if it proved to exist.

On March 19, rather late in the day, Dirks also called Institutional Capital Corp. in Chicago because a review of Delafield Childs' prior-contact sheets indicated that that firm had manifested an interest in EFCA. Dirks first spoke to Gerald Dhall, a portfolio manager with whom he had had occasion to speak before. Prior to relating any of the Secrest allegations, Dirks first ascertained that Institutional Capital did then own EFCA stock, though the size of the holding was not disclosed. Dirks told Dhall that a former Bankers National employee had told Dirks that EFCA's 1972 earnings were overstated, that EFLIC had been creating fictitious insurance policies and assets, and that EFLIC had been counterfeiting death certificates and certificates of deposit.

At Dhall's request, Dirks repeated the allegations to William Maloney, president of Institutional Capital. Maloney asked what basis Dirks had for relaying these rumors. Dirks replied that he had spoken to two former employees and also indicated he had an appointment to meet with EFCA's president Goldblum in Los Angeles on March 27. Maloney indicated that was

not soon enough, that Dirks could get into a lot of trouble by relaying non-public rumors in this fashion, and that Dirks should fly to the West Coast immediately and confront Goldblum with the allegations. Indeed, Maloney offered to defray Dirks's expenses in going to the West Coast.[30]

After spending much if not most of the day on the 19th on matters relating to the Secrist allegations of fraud at EFCA, Dirks decided abruptly to accelerate his trip to Los Angeles. He took an 11:00 p.m. flight out of New York City and checked into the Beverly Wilshire Hotel in Los Angeles at 2:00 or 3:00 a.m. local time on March 20th. His unscheduled departure meant that Dirks's appointments for the 20th in Hartford, Conn., with three major insurance companies, had to be covered by his associates.

In Los Angeles, on March 20, Dirks met with Hopper from about 9:30 a.m. to approximately 4:30 p.m. Hopper related he had been at EFCA in Los Angeles until August, 1971, at which time he had been sent to Bankers National as vice president for investments. He said he resigned from Bankers National on December 14, 1971, but stayed on until March 10, 1972. He stated he resigned because EFCA officers had wanted him to engage in improper activities, including the use of Bankers National funds as compensating balances for bank loans to EFCA.

The conversation included a discussion of the fact that it was Hopper who suggested that Secrist approach Dirks when Secrist sought advice from Hopper as to how the EFCA fraud could be exposed.

Hopper told Dirks that before leaving EFCA to go to Bankers National, he had heard allegations of fictitious insurance and other fraudulent practices and that later, at Bankers National, he talked with other middle-level executives who had

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[30] As it turned out, Maloney never thereafter offered to pay or share Dirks's expenses, and Dirks never asked for any assistance.

been sent by EFCA to Bankers National, from whom he heard the same allegations emanating from different sources, including Secrist. Hopper told Dirks that these stories tended to confirm one another, even though, as he was frank to say, he had no first-hand knowledge of the alleged fraudulent practices.

Hopper told Dirks that one reason he tended to credit the allegations was a series of conversations he had had with Frank Majerus, whom he regarded as a "nice guy", a very hard worker, very honest, and as a man who was afraid he would be going to jail because of his involvement.

Hopper also told Dirks that he considered Secrist to be honest and sincere, though at times given to hyperbole or to making statements he could not back up. Hopper reported that Secrist had been fired by Bankers National.

Hopper supplied Dirks with substantial detail regarding the alleged fraud at EFCA. At times this differed in particulars from what Dirks had heard from Secrist but its overall effect as an objective matter was clearly to corroborate rather than to refute the Secrist allegations. Nothing that Hopper reported to Dirks contradicted the Secrist allegations in any significant particular.

In the course of the day's discussion, Dirks returned a call from Zukowski of III and put Hopper on the line to talk to III directly, as found above.

Beginning at about 1:30 p.m. on that same day, March 20, Dirks and Hopper met with Frank Majerus, a former comptroller of EFLIC who had also worked briefly at Bankers National and whose reports of fraud at EFCA Hopper had told Dirks he credited.

Most of the approximately 1½ hours of conversation that followed was between Dirks and Majerus. After some initial hesitancy, Majerus freely discussed "Y business" and "special class" business, meaning policies issued to EFCA employees free of first-year premium.

Among other things, Majerus reported that as of the end of 1970 insurance in force at EFLIC was falsely made to rise sharply and that, at Lloyd Edens's request, he and Hopper had prepared false ledgers for earlier portions of the year in order to reflect a purported normal growth pattern for insurance in force. Dirks testified (R. 801) as follows about Majerus's reaction after reporting that information:

> And at that point he sort of dropped his head down and said, "I think I'm going to jail."

Majerus reported he had consulted his minister about the ethical problem he faced and was advised that in view of his family responsibilities he would be justified in remaining with the company until he could find suitable other employment. Majerus reported that Jim Smith and Lloyd Edens had talked him out of resigning at one point but that, nevertheless, after a relatively short stay at Bankers National, he resigned to go with another insurance company.

The details that Majerus provided Dirks, though varying in some particulars, tended to confirm in important respects what Secrist and Hopper had earlier told Dirks. In addition, the greater personal involvement that Majerus conceded and his reports of his personal ethical problems and his fear of going to prison for his involvement, viewed objectively, afforded a significant additional element tending to support the truth of the allegations of fraud at EFCA.

Dirks urged Majerus to contact William Blundell, the Los Angeles Bureau Chief of the *Wall Street Journal*, to tell him what he had conveyed to Dirks. (Blundell had called Dirks on the 20th and made an appointment to meet with Dirks on the 21st after Dirks had on the 20th again called Lawson of the *WSJ* in San Francisco, advising him that he, Dirks, was now in Los Angeles and again seeking Lawson's help with the investigation of EFCA).

On the afternoon of March 20, Dirks, returning a call, spoke with Tomlin and Zimmerman of TZP, and conveyed to them only the so-called "soft story" about EFCA, as found above.

During the evening of March 20 Dirks called Baker of III to inform him of the results of his meeting with Majerus, as found above.

Before retiring for the night on March 20, Dirks, for the first time in his life, pulled up two or three chairs against his hotel room door, because of concern resulting from Secrist's allegations that EFCA employees had in the past been frightened into silence by threats that a Mafia "contract" would be put out on them.

On Wednesday, March 21, a.m. in Los Angeles and p.m. in New York City, Dirks learned in a telephone conversation with Zukowski that III had sold its EFCA holdings in client accounts and that Dirks's firm, Delafield Childs, would be receiving $25,000 in commission business from III, as found above.

On the morning of March 21, following a call from Goldblum suggesting that they get together, Dirks met with Goldblum and Levin at his hotel. Dirks chose to meet at a public place, the hotel's Hideaway Bar, rather than his hotel room, because he was concerned about his personal safety.

Upon meeting, Dirks asked Goldblum how he was. Goldblum replied ". . . not so good. Our stock just dropped four points on a block of 400 and some thousand shares . . ." Dirks responded ". . . my god, that must be the Boston Company . . ." [meaning III].

Dirks told Goldblum and Levin that he had been talking to some former employees who were alleging the existence of fictitious insurance policies at EFCA and briefly described the nature of the allegations. Both categorically denied the allegations, attributed them to disgruntled employees, endeavored to show how legitimate activities might have been misconstrued, and emphasized that it was preposterous to suppose that such a fraud would remain undetected by the cognizant regulatory bodies.

Following the meeting at his hotel, which lasted about a half hour, Dirks accepted Goldblum's invitation to visit the EFCA offices. Dirks spent about three hours there, in Levin's office, where he spoke, among others, with Goldblum, Levin, Edens and Smith. The EFCA personnel discounted and denied each of the several allegations of fraud that were there discussed. Nothing was said in this session that would conclusively prove or rebut the Secrist fraud allegations.

At about 3:30 p.m. on March 21 Dirks kept his appointment with Blundell of the *Wall Street Journal*. The meeting lasted 2 to 2½ hours.

With the aid of his extensive notes, Dirks related to Blundell the substance of all he knew concerning the Secrist allegations of fraud at EFCA. Dirks showed Blundell his notes and described his meetings with Secrist, Hopper, Majerus, and the EFCA officers. Dirks ran through the names of the people Secrist had told him were involved or had knowledge of the fraud.

Dirks gave Blundell the phone numbers of Majerus, Hopper, and Secrist and asked Blundell to help investigate and publicize the allegations.

Shortly after his conversation with Blundell on March 21, Dirks received a call from Walter Delafield, to whom Dirks reported at Delafield Childs. Delafield reported that he had received a call from Jarvis Slade of New York Securities, an EFCA underwriter, complaining that a Bankers Trust analyst was making or relaying allegations of fraud at EFCA and that Slade had indicated he had determined Dirks to be the source of the allegations.

At about 8:00 a.m. on March 22, Dirks received a call from Goldblum. Dirks testified he got the impression Goldblum was trying to feel Dirks out as to what he was going to do. Goldblum said he was on his way to New York City and requested Dirks's permission to tell the New York Stock Exchange that Dirks was not alleging fraud at EFCA. Dirks gave his permission,

saying he had merely related to (unspecified) others the same allegations of former employees that he had reported to EFCA officials the previous day.

Dirks then called Blundell and told him of his conversation with Goldblum. He also asked Blundell whether he was investigating EFCA and the latter responded that he was beginning to make checks.

At about 12:30 p.m., Los Angeles time, on March 22, Dirks spoke with Tomlin and Zimmerman of TZP, as found above.

Later that afternoon Dirks spoke with Orphanos of Dreyfus, as found above.

On March 22 Dirks placed a call to Peter J. "Ron" Ronchetti, a former EFLIC employee, but did not reach him. Later Ronchetti returned the call and they arranged to meet for breakfast the following day, March 23.

On March 22 Dirks also telephoned another former EFCA employee, Gene Thibodeau, whose name Secrist had suggested. Thibodeau was then working in Denver. Their conversation lasted about 20 minutes.

After Dirks inquired about the fictitious insurance allegations, Thibodeau confirmed that he had been employed in EFCA's computer department and said there was substance to the information concerning "Y business". Thibodeau told Dirks he had begun work at EFCA in October 1970 and that he had left a year later because he didn't want to be a part of the fraudulent activity. Thibodeau mentioned "department 99" as the computer code designation for certain fictitious insurance and suggested Ron Ronchetti and Don Goff as persons who might be able and willing to furnish additional data. Thibodeau said he was very glad that Dirks was looking into the matter.

As previously arranged, Dirks and Ronchetti met over breakfast on Friday, March 23, for about an hour.

Ronchetti told Dirks he had been at EFCA in Los Angeles until December, 1971, at which time he was transferred to

Bankers National. He said he remained there until July, 1972, at which time he was fired because he was critical of management.[31]

Ronchetti said he was aware while he was there that EFCA had fictitious insurance on the books in 1970 and 1971 and provided details as to types, what it was called, and reports from a friend as to the numbers of fictitious policies extant as of year end in 1970, 1971, and 1972. He said he had heard of fictitious assets and fake death certificates and that there were death threats.

Ronchetti stated that while employed in EFLIC's computer department he had become convinced that certain blocks of insurance were fictitious, partly because there was a lack of back up materials for certain series of policy numbers.

In response to a question from Dirks as to who might be in a position to supply additional information, Ronchetti mentioned numerous individuals who were either participating in the alleged fraud or who had knowledge of it. Among those mentioned by Ronchetti as persons who might be helpful to Dirks were Brian Tickler, who had left EFCA only four months earlier, and Don Goff, a current employee, whom Ronchetti described to Dirks as knowing as much as or more than anyone. During the course of their discussion Ronchetti telephoned Goff and made a luncheon appointment for the three of them for that day.

After the March 23 breakfast meeting with Ronchetti, Dirks telephoned Brian Tickler in San Francisco. They conversed for about 25 minutes. Tickler confirmed that he had worked for Datair Corporation, a computer service organization that had had a contract to do computer work for EFCA/EFLIC until March, 1972. Tickler said he personally had not worked at EFCA since the end of 1971.

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[31] The record is not clear whether Ronchetti had returned to EFCA at Los Angeles sometime before being fired. See R. 1007, lines 19-21.

After Dirks outlined the Secrist allegations, Tickler responded that he would stake his career on the existence of "Y" business at EFCA and EFLIC in 1970, though he couldn't be sure of 1971. He explained to Dirks the basis for his conclusion that in 1970 there were 10 to 12 thousand fictitious policies extant on the basis of what kept coming out on computer runs even after certain corrections had been made.

Tickler said departments "99" and "96" were special code numbers on the computer tapes designed to cover the phony policies.

Tickler told Dirks that Don Goff was aware of the fraud and that Ron Secrist was very worried and morally concerned about the whole matter.

Tickler also told Dirks that he was ". . . delighted that you're looking into this." (R. 1106).

During the morning of March 23, Los Angeles time, Dirks had telephone conversations concerning the allegations of fraud at EFCA with Quinn of Dreyfus and Zukowski of III, as found above. On the same day Dirks placed a call to TZP intending to report details of what he had heard concerning allegations of insurance fraud at EFLIC, but he was unable to reach either Tomlin or Zimmerman.

Around mid-day on March 23 Ronchetti picked Dirks up, and they met with Goff over lunch for about an hour and a half to two hours. Goff, who was still employed by EFCA, had been a computer systems analyst and supervisor until moving into a "different area" towards the latter part of 1972. Among other things, Goff confirmed the existence of code designations for blocks of fictitious insurance. Goff indicated his understanding that there were 11,000 bogus policies in 1970, 45,000 in 1971, and 55,000 such policies in 1972. These figures were similar to but not identical to those Dirks had heard earlier from Ronchetti. Goff reported that he had heard that an EFCA employee aware of the bogus insurance had "embezzled" $35,000 by turning in 12 such policies to the re-insurers for cash value. Goff stated that he understood EFCA maintained a "mass

marketing" or records-creation group away from its Century City offices, whose function it was to create fictitious backup files and records for the bogus insurance. He said that EFCA utilized a printing plant somewhere to fabricate documents for that purpose.

Dirks concluded that Goff was ". . . very cool, calm and collected . . .", ". . . a fairly credible type of individual", and that ". . . what he was saying was what some of the other people were saying. . . ." R. 1032.

After the luncheon meeting with Goff and Ronchetti, Dirks called Blundell of the *WSJ*. He told Blundell that he had spoken to one present and two former employees of EFCA who tended to substantiate portions of the Secrist allegations. Dirks gave Blundell the names and telephone numbers of Goff, Ronchetti, and Tickler, and related the substance of his conversations with them. Dirks asked whether Blundell would run a story in the *Journal*. Blundell responded noncommittally, but stated that he had reported the Secrist allegations to the Securities and Exchange Commission.

In the afternoon of March 23 Dirks conversed by telephone with Orphanos of Dreyfus, as found above.

On March 23 Dirks returned a call to Fiduciary Trust Company and spoke with Peter Alsop, with whom he had not had occasion to speak before. After Alsop indicated that Fiduciary held substantial EFCA securities, Dirks told him that he had spoken to several former EFCA employees and related to him the substance of their allegations of fraud at EFCA/EFLIC.

Additionally, during the week of March 19, Dirks spoke on several occasions with Dhall or Maloney of Institutional Capital to report the progress of his investigation. In one such conversation Dirks reported his meetings with EFCA personnel and in another he reported that he had spoken to several former employees and one current employee of EFCA and that they tended to confirm portions of the Secrist allegations.

By late afternoon of March 23, after having spoken to one current and six former EFCA employees,[31a] Dirks became concerned about exposing the fraud, if it was a fraud, as soon as possible. He was aware that Seidman & Seidman were planning to release a certified audit statement on Monday, March 26. Dirks believed that if he apprised them of the allegations they would hold up release of their audit report and would seek a trading halt from the New York Stock Exchange pending confirmation or refutation of the allegations.

Dirks called an acquaintance at the Centennial Corporation for guidance as to what top partner at Seidman & Seidman Dirks could talk to in confidence. Dirks then contacted the partner suggested and was told he could "feel very safe" in calling Robert Spencer, Seidman & Seidman's senior Los Angeles partner. Dirks contacted Spencer, who said it sounded like "quite a story." They agreed to meet the next day, a Saturday.

It occurred to Dirks that EFLIC's former auditors should also be apprised. At about 5:00 p.m. on March 23 Dirks called Michael Balint, the partner in charge of Haskins & Sells' Los Angeles office, to whom Dirks had spoken previously about EFCA. After Dirks outlined briefly the fraud information he had received, Balint advised him to leave his hotel immediately for his personal safety and call him back at home in about an hour. Dirks picked up his papers in a hurry and checked into the Beverly Rodeo Hotel under the name of Allen Gorrelick [his associate]. Dirks kept his room at the Beverly Wilshire Hotel, to serve as a place where he could continue to receive messages and, in Dirks's words, ". . . if anybody were coming after me, why, they wouldn't know I had left." (R. 1133.) When Dirks later called Balint at home, they made arrangements to meet for dinner the next night.

[31a] Tickler was not an employee of EFCA or a subsidiary, but as an employee of a contractor doing computer work for EFCA he had opportunity to acquire knowledge of the alleged fraud.

On Saturday, March 24, Dirks met with Spencer of Seidman & Seidman. Dirks related the general substance of the allegations of fraud at EFCA and then allowed Spencer to copy extensive notes he had taken. Spencer assured Dirks they would investigate the situation before releasing their impending certified audit report.

On March 24 Dirks called Orphanos of Dreyfus at home, as found above.

When Dirks met Balint of Haskins & Sells for dinner that evening, the latter rejected Dirks's idea that they dine near his hotel, saying that they had better get out of that area. They therefore drove some 20 miles down the coast to have dinner. They discussed EFCA for about seven hours. Dirks discussed the allegations he had heard in detail.

Balint said Haskins & Sells had been EFLIC's accountants since 1967 and that the firm's last audit of EFLIC was in 1971. Balint stated he knew nothing of the alleged fraud but expressed the view that if top management of the company were in collusion, had perpetrated a fraud, it was conceivable that that could have happened without the auditors' having become aware of it.

After his discussion with Spencer and Balint, Dirks believed it unlikely that EFCA stock would open for trading on Monday, March 26, because he expected trading to be halted by the NYSE.

On Sunday evening, March 24, Dirks met with Quinn of Dreyfus in Los Angeles, as found above.

On Monday, March 26, at about 10:30 a.m., Dirks learned in a telephone conversation with Ronchetti that Goff had learned that Seidman & Seidman had given copies of Dirks's extensive notes to top EFCA management.

As Dirks reported to Blundell of the *WSJ*, this little bit of intelligence caused him to run out of his hotel room in a "state of panic". Dirks asked whether Blundell could do something about publishing the allegations.

Later in the day, at about 3:00 p.m., Dirks again spoke to Blundell and asked if he was prepared to publish the story. Blundell indicated he was meeting shortly with three representatives of the SEC's Los Angeles Regional Office and got Dirks's permission for Blundell to ask whether the SEC wanted to meet with Dirks, Hopper, and Majerus.

Later in the day Blundell called Dirks to report that the SEC officials would like to meet with Dirks, Hopper, and Majerus.

Several hours after that, Dirks and Hopper met with Blundell for several hours to discuss further the allegations of fraud at EFCA.

That evening, Dirks and Hopper contacted Gerald Boltz, the Commission's Regional Administrator in Los Angeles, and made arrangements to appear at the SEC's offices at 9:00 a.m. the following morning.

Apart from the foregoing, Dirks had a number of other contacts on March 26 concerning the allegations of fraud at EFCA. The order in which they are referred to here is not necessarily in chronological sequence.

On March 26 Dirks spoke with Bristol of Bristol & Co., Tomlin and Zimmerman of TZP, and Manning of Manning & Napier, all as found above.

On March 26 Dirks also related to personnel at the Savings and Profit Sharing Trust of Sears Employees the allegations of fraud at EFCA, including information regarding bogus policies, "Y" business, etc.

On the same date he called Fidelity Management and Research in Boston, but he did not relate the fraud allegations to them, because he learned they did not own EFCA stock.

On March 26 Dirks also returned a call to Lawton General, an investment subsidiary of Loews Corporation. Dirks spoke to Wallace Bowman, whom he understood to be in charge of Loews' investment portfolio. Dirks was aware at the time that Lawton had that morning purchased a substantial block of

EFCA. Bowman said he'd heard that Dirks had a story about EFCA. Dirks replied that he assumed the stock Loews had purchased that morning was stock Bristol & Co. had sold, and that he'd give Bowman the same information he'd given Bristol. Dirks then gave Bowman the full story about allegations of fraud at EFCA as he understood them, and also put Hopper, who was with him at the time, on the line to talk to Bowman.

On the evening of March 26 Dirks received a call from Harold Richards of Fidelity Corporation of Virginia. Richards said Fidelity was the largest EFCA stockholder and said he'd heard Dirks was doing some analysis of EFCA. Dirks told Richards he'd been talking to some former employees and one current EFCA employee and that they had made allegations of fraud. Richards interjected and said he had a tape recorder running, to which Dirks responded that he had no objection. Dirks also urged Richards to come out to Los Angeles personally, but Richards demurred, saying he did not fly. Dirks gave Richards a pretty complete recitation of the allegations, as he had given Loews.

On March 26 or early March 27, Dirks related the allegations of fraud at EFCA to Steinhardt, Fine and Berkowitz. Early on March 27 Dirks conveyed briefly to an analyst at Morgan Guaranty the allegations of fraud at EFCA after learning that Morgan Guaranty had an interest in EFCA.

On March 27, sometime before 8:30 a.m., Los Angeles time, Dirks placed a call to an insurance analyst at the Ford Foundation. Unable to reach him, Dirks spoke instead to the head of research. Dirks did not recall the length of the conversation or the extent to which he went into the allegations of fraud at EFCA.

On March 27, at 12:45 p.m., (E.S.T.), trading in EFCA securities was halted by the NYSE. The following day, March 28, the SEC suspended trading in EFCA, securities.

In the course of Dirks's investigation into the allegations of fraud at EFCA and his selective dissemination of the allegations he heard to the selling respondents and to others, Dirks

directly and indirectly used and caused to be used the mails and means and instruments and instrumentalities of transportation in interstate commerce, i.e. travel between New York and California and local and long distance telephone lines. In addition, in the course of such investigation and dissemination, Dirks, as is brought out more directly in other portions of this decision, directly or indirectly caused others to use, or aided and abetted their use of, the facilities of the New York Stock Exchange in liquidating EFCA holdings of their clients.

C. Elements Of The Charged Violations; Respondents' Contentions.

Trading by a corporate or other insider or his tippee on the basis of material inside information not publicly known and not properly disclosed is well established as a violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.[32]

Section 17(a) and Rule 10b-5 provide, respectively, as follows:

> **FRAUDULENT INTERSTATE TRANSACTIONS**
>
> Section 17. (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

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[32] E.g. *Cady, Roberts & Co.*, 40 S.F. C. 907 (1961); *S.E.C.* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833 (2d Cir. 1968) (Rule 10b-5); *Investors Management & Co. Inc., et al.*, 44 S.E.C. 633 (1971).

Rule 10b-5. Employment of Manipulative and Deceptive Devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

The three numbered clauses of Section 17 and Rule 10b-5 have been held to be mutually supportive rather than mutually exclusive. Thus, a breach of the duty of disclosure may be viewed as a device or scheme, an implied misrepresentation, and an act or practice, violative of all three clauses. However, a finding of violation of a particular clause, e.g. clause (3), renders it unnecessary to consider whether the other two clauses have also been violated.[33]

Non-public information

The record herein establishes beyond serious challenge that the information regarding allegations of fraud at EFCA received by the individual selling respondents was non-public at the times they received it and at all times up to the times they sold or attempted to sell their clients' EFCA securities.

No published report of allegations of fraud at EFCA available generally to the investing public appeared until publication on April 2, 1973 of Blundell's Pulitzer-nominated article in the *Wall Street Journal*. The Dow Jones Broad Tape, *after* the

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[33] *Cady, Roberts & Co.*, 40 S.E.C. 907, 913 (1961).

close of trading on March 26, reported that heavy trading in EFCA had been accompanied by rumors concerning EFLIC, which rumors were reported as centering ". . . on the accuracy of the subsidiary's reported statements of new policies written and total insurance in force." The report contained no attribution of source or indication of magnitude or details of the problem. The gist of this report was published the next day in the *Wall Street Journal*, again without the details that would be necessary to make the information equivalent or comparable to that received by the selling respondents.

Even incident to or following the halting of trading in EFCA stock by the New York Stock Exchange on March 27 and the suspension of trading on March 28 by the Commission there was no publicly available report concerning fraud at EFCA analogous to the information received earlier by the selling respondents until the mentioned *Wall Street Journal* article of April 2.

Information derived from inside sources

Secrist and five other ex-employees of EFCA[32a] and one current employee (Goff) of EFCA, from whom Dirks obtained information respecting allegations of fraud at EFCA in the course of his investigation, were clearly "inside sources" since they were reporting information that had come to their attention while they were employees of EFCA or an affiliate. Jacobs, *The Impact of Rule 10b-5* (1974) § 66.02[a], at p. 3-275, note 46. These employees did not have to be officers (although most were in fact second-level managers or officers), directors, or controlling shareholders. *Ross* v. *Licht*, 263 F. Supp. 395, 409 (S.D.N.Y. 1967); *S.E.C.* v. *Texas Gulf Sulphur*, 258 F. Supp. 262, 279 (S.D.N.Y. 1966), *affirmed in part*, 401 F. 2d 833 (2d Cir. 1968).

The law is well settled that selling respondents as "tippees," even though they received their inside information wholly or in

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[32a] See footnote 31a above.

large part through an intermediary (Dirks), became subject to the same disclosure requirements as governed the insider "tippers", i.e. EFCA employees and ex-employees having information concerning the alleged fraud at EFCA. One who knows himself to be a beneficiary of non-public, selectively disclosed inside information must fully disclose or refrain from trading. *S.E.C.* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833, 848 (2d Cir. 1968) (en banc), *cert. den.* 394 U.S. 976 (1969); *Shapiro* v. *Merrill Lynch*, 353 F. Supp. 264, 276, 279 (S.D.N.Y. 1972); *Faberge*, Securities Exchange Act Release No. 10174 (May 25, 1973) [1973 Decisions] Fed. Sec. L. Rep. (CCH) ¶ 79, 378, p. 83,105; *Investors Management Co., Inc. et al*, 44 S.E.C. 633, 639-41 (1971); *Merrill Lynch, Pierce, Fenner & Smith*, 43 S.E.C. 933, 936 (1968).

Materiality of the inside information

Materiality is a mixed question of fact and law, involving as it does the application of a legal standard to a particular set of facts.[34] The circumstances under which each selling respondent received non-public, inside information, as found herein, were different, and the question of materiality must be determined individually for each selling respondent on the basis of the facts applicable to it.

The criteria or tests for determining materiality elucidated by the courts tend to take on colorations stemming from the particular facts involved, which makes discernment of a single, all-encompassing test of materiality difficult at best. One writer perceives three categories of tests:

> The courts have not settled on a single objective test to determine whether a fact is material. Three categories of tests can be discerned: One dealing with the judgment of a reasonable investor or reasonable stockholder, another

[34] *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 450 (1976).

> weighing the probability that an event will occur against its indicated magnitude, and a third concentrating on the market impact of a disclosure.[35]

The first basic test referred to by Jacobs, as relevant to the instant proceeding, may be stated as follows: Would a reasonable investor consider the information important in deciding whether to purchase, sell, or hold.[36] This test is stated in terms of "would" rather than "might" in view of the Supreme Court's decision in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976), involving a proxy solicitation under Rule 14a-9 issued under the Securities Exchange Act, where the Court, at p. 449, held, after discussing the "would" vs. "might" split among the circuits:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. [emphasis supplied] [*sic*]

Prior lower court and Commission decisions respecting tests of materiality, including those cited above, must be read as having had their "thresholds" raised from the "might" to the "would" level wherever necessary. See, e.g., *SEC* v. *Bausch & Lomb Inc.*, 565 F.2d 8, 14-15 (2d Cir. 1977).

Another basic test of materiality from the third category referred to by Jacobs, as relevant here, may be stated as follows: Would disclosure of the inside information, in reason-

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[35] Jacobs, *The Impact of Rule 10b-5* (1974), § 61.02[b], pp. 3-74, 3-75.

[36] *SEC* v. *Shapiro*, 494 F.2d 1301, 1305 (2d Cir. 1974); *Radiation Dynamics* v. *Goldmuntz*, 464 F. 2d 876, 887-88 (2d Cir. 1972); *SEC* v. *Texas Gulf Sulphur*, 401 F. 2d 833, 849 (2d Cir. 1968), *cert. denied sub nom. Coates & Kline* v. *SEC*, 394 U.S. 976 (1969); *List* v. *Fashion Park*, 340 F. 2d 457, 462 (2d Cir. 1965); *cert. denied sub nom. List* v. *Lerner*, 382 U.S. 811 (1965); *Shapiro* v. *Merrill Lynch, Pierce, Fenner & Smith*, 353 F. Supp. 264, 272 (S.D.N.Y. 1972); *Investors Management Co. Inc., et al.*, 44 S.E.C. 633, 642 (1971).

able and objective contemplation, have a substantial impact on the market price of the securities involved.[37]

These two standards for determining materiality, i.e. the effect of inside information on a reasonable investor's judgment and the impact of disclosure of the information on the market price of the involved security (Jacobs' categories one and three) are very similar and in all but a few situations overlap and coincide. Thus, information that would influence reasonable investors would cause a sufficient number of them to buy or sell (depending upon whether the information were favorable or unfavorable) to substantially affect the market price of the security. Likewise, inside information that would in the judgment of a reasonable investor substantially affect the market price of a security by causing a sufficient number of other investors to buy and sell would prompt him to buy or sell in anticipation of the expected market impact. While the U.S. Supreme Court has not in terms adopted the market-impact test, it is clear that the first test, which it does employ, is broad enough to encompass the market-impact test as well.[38]

A third basic test of materiality, listed by Jacobs as his second category and described by him in shorthand terminology as the "probability yardstick,"[39] comes into play only when the inside information involves an element of contingency or uncertainty as to the occurrence or existence of the event or condition that is the subject of the inside information, e.g. test bores that may or may not foretell a large mineral discovery,

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[37] *SEC* v. *Texas Gulf Sulphur, supra*, 401 F.2d at 849-50; *List* v. *Fashion Park, supra*, 340 F.2d at 462; *Kohler* v. *Kohler Co.*, 319 F.2d 634, 642 (7th Cir. 1963); *Investors Management Co., Inc., et al.*, 44 S.E.C. 633, 642 (1971); *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933, 937 (1968). Jacobs, *The Impact of Rule 10b-5*, § 61.02[b] pp. 3-81, 3-82 (1974).

[38] Jacobs, *supra*, § 61.02[b], pp. 3-83, 3-84.

[39] Jacobs, *supra* , § 61.02[b], pp. 3-75, 3-81.

negotiations that may or may not result in a merger, acquisition, or large contract, and the like. Where these elements of contingency or uncertainty exist, the test holds that probability must be weighed against the magnitude of the impact the information would have on the inherent value or prospects of the company or on the market price of its securities. The greater the potential impact, the smaller is the degree of likelihood or probability that needs to be present to make the information material.[40] This is but a reflection of how the objective, reasonable investor would be expected to respond to such circumstances, and is a corrolary [*sic*] of the other two basic tests.[41]

Since the allegations of fraud at EFCA were not admitted or otherwise clearly established prior to the times of the alleged violations by the selling respondents,[42] it is clear that the probability vs. significance basic test, along with the

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[40] *SEC* v. *Texas Gulf Sulphur*, 401 F.2d 833, 849 (2d Cir. 1968) (preliminary drilling results found material); *Investors Management Co., Inc., et al.*, 44 S.E.C. 633, 642 (1971) (adverse earnings *projections*, among other items); *SEC* v. *Shapiro*, 494 F.2d 1301, 1305-07 (2d Cir. 1974) (possible, though not probable, merger that would increase earnings 600%); Jacobs, *supra*, § 61.02[b] p. 3-81.

[41] Jacobs, *supra*, § 61.02[b] p. 3-81.

[42] The record establishes that the basic allegations of massive insurance fraud at EFCA were in fact true and that such operations were but part of an even larger fraud that precipitated EFCA into bankrutpcy [*sic*] under a petition filed April 5, 1973, under Chapter X of the Bankruptcy Act. On or about April 10, 1973, the Court appointed a Trustee for EFCA, which was ultimately reorganized and is now doing business as Orion Capital Corporation. In his report of October 31, 1974 (Div. Exh. 1), the Trustee reported that the insurance phase of the fraud was another means by which EFCA inflated its reported earnings. This involved generating fictitious premium and re-insurance income on EFLIC's books. Bogus insurance known to the conspirators as "Y business" and segregated on

reasonable-investor and market-impact[43] tests, needs to be employed in determining the issue of materiality. Under the facts presented by this record the three tests overlap considerably and will perforce at times be considered together.

Lastly, courts have at times employed a subjective test of materiality by looking to what individual recipients did in response to the receipt of inside information.[44] The better analysis is to view these uses of subjective indicia merely as applications of the reasonable investor test. That is, a court, or the Commission, having concluded that the recipient of inside

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EFCA's computers as "Department 99" was responsible for $5.5 million in non-existent premium income in 1970, and the figures for 1971 and 1972 were estimated at "up to $10 million" and "at least $14.67 million," respectively. The record establishes that Goldblum, Levin, and numerous other EFCA-EFLIC employees were involved in the fraud, as well as three accountants of the Wolfson, Weiner firm.

[43] The market-impact test discussed above is not to be confused with the so-called market information theory of liability. Market information has been defined as "information which emanates from non-corporate sources . . . primarily . . . concerning or affecting the trading markets for a corporation's security." *Oppenheimer & Co.*, [1975-76 Transfer Binder] Fed . Sec. L. Rep. (CCH) ¶ 80,551 at 86,415 n. 2 (Exchange Act Rel. No. 12319, April 2, 1976). In the instant proceeding knowledge of various selling respondents that Dirks as tippee was in turn selectively disseminating (tipping) the material inside information to others was inextricably interwoven with communication of the inside information itself to the selling respondents. Such knowledge was part of the totality of circumstances under which the selling respondents received the inside information. It therefore had a bearing on application of all three of the basic tests of materiality and should not be viewed as market information as if such had been received in isolation.

[44] *SEC* v. *Shapiro*, 494 F.2d 1301, 1307 (2d Cir. 1974); *SEC* v. *Texas Gulf Sulphur*, *supra*, 401 F.2d at 851; *Cady, Roberts & Co.*, 40 S.E.C. 907, 911-12 (1961); Jacobs, *supra*, § 61.02[c], pp. 3-86 *et seq.*

information was under the circumstances in the position of a "reasonable investor," looks to his response to and use of the information as an indication of whether a reasonable investor under an objective standard would regard the information as material. This analysis retains the objective character of the basic tests of materiality. It should be noted in this connection that there is generally, or at least frequently, another reason for inquiring into a recipient's or holder's response to the receipt or possession of inside information, i.e. to establish whether he acted on the basis thereof or on the basis of some independent and unrelated cause.

In this proceeding most selling respondents contend they acted on the basis of independent motivations and considerations, and findings on those assertions are of course required. Depending upon their nature, such findings may also be relevant on the issue of materiality, and they are therefore treated under this issue.

In *Investors Management*[45] the Commission looked among other indicia of materiality, to the degree of specificity of the inside information, the extent to which it differed from information previously disseminated about the company, and its general reliability in light of its nature and source and the totality of the circumstances in which the information was received. These indicators are pertinent here.

Although each selling respondent received the inside information concerning allegations of fraud at EFCA in varying detail and in varying degrees of specificity, it is clear from the findings herein that each of them received information that clearly met the requirements of specificity. As a minimum, the allegation received was that there was bogus or phantom insurance in a substantial amount at a subsidiary of EFCA either presently or during a fairly recent period with a good possibility that some fraudulent insurance was still on the books. Most

[45] *Supra*, 44 S.E.C. at p. 642.

selling respondents heard a good bit more in terms of specificity, including code names for the bogus insurance, alleged involvement of management personnel, use of the computer in the alleged scheme, amounts of phony insurance in terms of percentage of policies or number of policies, fabricated and falsified records to carry out the alleged scheme, creation of phony certificates of deposit and other assets, etc. Respondents do not much question the specificity of the allegations; they strongly contest the believability of the allegations, an element considered at a later point herein.

The allegations of fraud at EFCA were unlike anything that EFCA had either publicly or within the investment community ever been charged with before. Although some elements of the generally-conservative insurance industry and some elements of the investment community considered EFCA to have a "soft shoe" image and a reputation for favoring "liberal" accounting practices, none of that began to approach the specific allegations of widespread insurance fraud that are involve here. In no sense could these fraud allegations be put into a "so-what-else-is-new" category. While there had been vague rumors in the past concerning EFCA's accounting practices or similar matters, they bore no semblance to the specific, startling allegations here involved.

Respondents strongly contend the fraud allegations were inherently incredible and that they were unbelievable because they came from an unreliable source, a disgruntled, fired employee.

Respondents' arguments respecting the reliability and believability of the fraud allegations overlook a number of significant factors.

Firstly, fired or disgruntled employees, although they may inveigh against their former employers, are not likely to risk their professional reputations by bringing serious fraud charges against them of a nature that, when disproved, would be bound to bring industry-wide discredit upon the accuser. Secrist came to Dirks for help in exposing what he considered a

fraud at EFCA, not to damage EFCA in some surreptitious way that would forever protect his own identity as the informer. Dirks later learned that Secrist had also taken his allegations to an Eastern regulatory agency [the New York State Insurance authorities] and Dirks advised some of the selling respondents of that fact. Although Secrist at first asked Dirks to keep his identity secret, it became clear as events unfolded that Secrist was willing to speak to a number of people, including a representative of at least one selling respondent, in order to help expose the fraud, even at the risk of disclosing his identity. As Dirks's investigation progressed, Secrist was increasingly willing to let his identity become known.

Moreover, Secrist was not the only source of the fraud allegations. By the time Dirks conveyed the inside information to the last of the selling respondents he had talked to one current EFCA employee and six former employees.[45a] By the time Dirks completed his contacts with III, the first of the selling respondents to liquidate its clients' EFCA holdings, Dirks had talked to two other ex-EFCA employees: (a) Hopper (indeed, Hopper personally talked by phone with III) and (b) Majerus. As Secrist's allegations found support from additional ex-employees of EFCA and one current employee, the reliability of Secrist and each of the others as a source became enhanced and strengthened. Surely a reasonable investor would not suppose that they were all demented or misconstruing innocent facts and circumstances as a basis for serious fraud charges at the risk of their professional reputations.

This is not to say that these sources "established" or "proved" the fraud charges; but certainly they raised the likelihood that the charges had some validity to a level that would cause a reasonable investor to want to consider and weigh such

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[45a] See footnote 31a above.

information as a part of the "total mix" of information available to him about EFCA before making an investment decision.[46]

Moreover, the fact that Dirks, an experienced insurance company analyst, was investigating the Secrist allegations and reporting his results to, among others, the selling respondents, is a fact that in itself, in the circumstances found herein, served to enhance substantially the believability and reliability of the particular fraud information received by each of the selling respondents.

While Dirks testified at the hearing in this proceeding that he did not believe the fraud allegations, his dogged determination and persistence in pursuing his private investigation into the allegations and his systematic program of selectively disclosing the results of his investigation to large institutions that held EFCA securities or "had an interest" unmistakeably [*sic*] belie his testimony.

Dirks's personal belief as to the likelihood that the fraud allegations were true is relevant at this point of the discussion because his belief must necessarily have reflected itself in the tone and in the conviction, or lack of it, with which Dirks communicated the fraud information to each of the selling respondents.

Dirks's early and growing belief that the fraud allegations regarding EFCA were to a significant extent more probably true than not true is evident from a large number of facts and circumstances.

Secrist approached Dirks with the allegations in the hope and expectation that Dirks would help expose the fraud by jogging the market for EFCA securities through dissemination of the information. As the findings herein show, Dirks promptly embarked on a course of selective dissemination of

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[46] *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976).

the allegations that had precisely that effect. Even after Dirks became aware that his "tips" had prompted specific sales of EFCA securities in substantial amounts that were quite clearly adversely affecting the price of EFCA securities, he knowingly continued his program of selective dissemination to anyone who owned EFCA stock or "had an interest" in EFCA. My assessment of Dirks, formed during the extended periods of his testimony in this proceeding and on the basis of the entire record, is that he is not not [*sic*] a person who would in mean or reckless fashion have embarked upon and continued a course of conduct so clearly harmful to EFCA on a mere possibility that the charges were true and in order to "smoke out the truth" at such damage to EFCA. My assessment is that he would only have done so under a belief that the allegations, or a substantial portion thereof, were more probably true than not. This is particularly the case in light of Dirks's having previously met and known Goldblum and other officers of EFCA.

In connection with Dirks's rather extended campaign of selective dissemination of the fraud allegations, the findings show that Dirks made this his major, and for over a week virtually his sole, concern. In a couple of cases he put Hopper on the line to talk directly to his tippees. In a number of cases he gave tippees the names and phone numbers of his informants, so that tippees would be free to make their own contacts if they desired. These actions by Dirks, under all the circumstances, indicate not a "neutral" posture on his part but that he was endeavoring to persuade the tippees that there was substance to the fraud allegations.

The findings herein also show that concurrently with his selective disclosures of the fraud allegations, Dirks repeatedly prompted a *Wall Street Journal* reporter to come out with a story on the allegations. Again, it is my judgment of Dirks that he is not a person so base or reckless as to have urged this course absent a belief that the allegations were more probably true than not. This conclusion is based not only upon an evaluation of his character in terms of willingness to harm EFCA but upon an [*sic*] a judgment that he was concerned enough about

his own self interest not to have wanted to jeopardize his credibility and reputation both with the *Wall Street Journal* and with the investment community in which he worked by spreading serious fraud allegations absent a belief on his part that the allegations were more probably true than not.

What Dirks heard as his investigation progressed tended to confirm rather than to disprove Secrist's allegations, even though there were some peripheral contradictions or anomalies. At no time did Dirks tell any tippee that he disbelieved the allegations, even though he might have characterized the allegations as "incredible." In the total contexts in which Dirks used the term, it is clear that he was employing "incredible" in the sense of "extraordinary" or "bizarre." As found herein, Dirks specifically told one tippee, John Bristol, that if he were in Bristol's position he would sell the EFCA holdings. Dirks's contemporaneous reports of fears for his personal safety also say much about the state of his belief.

Dirks's personal belief as to the reliability or believability of the fraud allegations can also be judged in terms of the effect he expected their dissemination to have upon his tippees. Testifying before representatives of the New York Stock Exchange, Dirks testified (R. 1920) in part:

> But I thought most of them would sell, if you want my opinion.

In light of all of the foregoing circumstances Dirks's testimony at the hearing that he at no time "believed" the fraud allegations is not credited; he obviously could not be sure, but his entire, extended course of conduct establishes that he believed a substantial part of the fraud charges to be more probably true than untrue.

The nature of the inside information is in itself a potent indication of materiality. A reasonable investor would recognize at once that allegations of widespread fraud at EFCA involving top management would, if true, have a devastating effect on EFCA both because of its effect on the assets or real worth of the company and because of the market impact on the

price of its securities. A reasonable investor would also realize that such allegations, in light of what they were and of the total circumstances in which the allegations were received by each selling respondent, would have a sharp negative impact on the price of EFCA securities, whether the allegations ultimately proved to be true or false. This last conclusion is so because a reasonable investor standing in the position of any one of the selling respondents would realize that in light of Dirks's continuing selective dissemination of the allegations, enough recipients of the information would sell the stock (without awaiting the ultimate proof or refutation of the allegations) to seriously depress the market price of EFCA securities.

This consideration of the nature of the inside information as an indication of materiality of course involves application of the probability vs. significance weighing test discussed earlier. The test is particularly applicable to this case. In view of the horrific nature of the fraud allegations, a reasonable investor would not be expected in all cases to wait for proof positive before disposing of his EFCA holdings. And, as III's trader Moore aptly expressed it, a rumor involving fraud would "spread like wildfire" within the brokerage community. III's Zukowski, likewise, recognized that the spreading of such information could be "deadly," as found above. This does not mean that *all* reasonable investors would necessarily react uniformly to the receipt of the information received by each of the selling respondents. But it does mean that a reasonable investor would recognize that a significant enough number of recipients of the information would react by liquidating their EFCA holdings that the price of the stock would be serious affected. Under the "probability yardstick" the fraud allegations were clearly material information.

As a further point under the general question of materiality there remains for consideration how the selling respondents regarded the fraud allegations and how they responded to their

receipt of the information,[47] i.e. the subjective application of the objective materiality tests discussed above. This exposition will show, concurrently, that the inside information received by each selling respondent was a significant element in its decision to sell its clients' EFCA securities. (See pp. 113-14 above).

The findings made herein show clearly that the inside information concerning allegations of fraud at EFCA received by Respondent III was deemed material and that it constituted a significant, indeed controlling, factor in III's decisions to liquidate its clients' EFCA securities. It is sufficient to highlight some of the more salient findings, without attempting to summarize all of the relevant findings.

Promptly after hearing the fraud allegations from Dirks, III initiated and continued extensive efforts to attempt to confirm or refute the information. III thus clearly recognized the significance of the information if true. The efforts at verification, or "checking," eventually involved all portfolio managers at III as well as Wise, who had no primary portfolio responsibility. Courtney had a lengthy face-to-face visit with Dirks and Gorrelick in which the fraud allegations were discussed in considerable detail. In addition, III made a legally-ineffectual stab at seeking legal counsel on the question of whether it was in possession of inside information (the defense of reliance upon legal counsel is treated separately below). Moreover, III, through Zukowski and Baker, continued to have numerous telephone discussions of the matter with Dirks over an extended period, both before and after Dirks carried his investigation to Los Angeles. The last of these contacts was a call

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[47] As suggested above, Dirks clearly viewed the information as material or he would not have been disseminating it to selling respondents and others. Also, as found above, he expected most of the firms he contacted to respond by selling their EFCA holdings, meaning that he expected most of them to regard it as material also.

from Dirks to Baker at the latter's home after Dirks had talked to Majerus, the third ex-employee contacted by Dirks, on the evening preceding III's completing its liquidation of EFCA holdings. Much earlier than the other portfolio managers, Courtney had concluded that the fraud allegations required disposition of the EFCA holdings. Thus, Courtney's clients were sold out first and from that time forward he continued to urge the others to sell. Unlike the others, Courtney did not consider that there was any point in further "checking." In a limited sense Courtney was right, because after extensive checks with a former auditor and with co-insurance companies and others, III was still not in position positively to confirm or refute the fraud allegations. However, as a result of the delay, III did become aware that three former employees told a basically consistent story and that the source therefore was not Secrist alone. These added confirmations, along with the inability to refute the allegations and the circumstances of III's realization that Dirks-induced sales of EFCA securities (including the Courtney-client sales) were already having a negative effect on the market price of EFCA securities and that that trend would continue as Dirks kept up his program of selective dissemination, combined to prompt the ultimate III liquidations. Significantly, III decided to liquidate its clients' very substantial EFCA holdings in the face of a prior determination that they would hold the securities pending an expected rally that had not materialized. III personnel testified that they realized that the fraud allegations and their selective dissemination by Dirks had killed off all possibilities of a rally. Finally, two *res gestae* type actions of III are significant: First, as a direct consequence of the fraud information given by Dirks, III directed brokerage business worth over $23,000 in commissions to Dirks's employer, Delafield Childs;[48]

[48] Testimony that this commission business was unrelated to the inside information furnished is not credited, based upon credibility evaluations and the record as a whole.

second, in reporting to his "bosses" the reasons for the EFCA liquidations, Courtney, employing somewhat euphemistic language, said that III had ". . . received disquieting information from the broker concerning potential adverse developments affecting the company," as found above.

Respondent Bristol & Co., as evident from the facts found above, also considered the allegations of fraud at EFCA that it received material and acted on that information to liquidate its clients' EFCA holdings. (The question of whether certain transactions were "sales" within the meaning of the relevant statutes is treated separately at a later point.) Bristol & Co. first received information concerning alleged fraud at EFCA from personnel at III after III had just completed liquidating its clients' EFCA holdings and at a time when Bristol was in the process of *acquiring* EFCA shares for a client of Bristol & Co. After having purchased 66,000 shares of EFCA for the client on March 22 (which purchase, ironically, came out of shares its affiliate, III, had sold), Bristol & Co. suspended its intended purchase of additional EFCA shares for the client and commenced to check out the allegations with various insurance analysts and two executive vice presidents of EFCA. The EFCA executives denied there was any substance to the rumors and the insurance analysts contacted either discounted the rumors or could not be helpful. Nevertheless Bristol had about concluded that the existence of the fraud allegations and the fact that Dirks was selectively disseminating the allegations dictated a liquidation of Bristol & Co. clients' EFCA holdings even before he and an associate held a telephone conversation with Dirks. Dirks stated that in Bristol's position he would sell and also advised that he (Dirks) had prevailed upon Majerus to talk to the former EFLIC auditors, Haskins & Sells, and that he (Dirks) had been talking to a *Wall Street Journal* reporter. From this last, Bristol inferred that the *Journal* would shortly be coming out with an unfavorable story regarding EFCA. Dirks also expressed the view that he doubted that trading in EFCA would be allowed to continue in view of his contacts with the former auditors. After this con-

versation with Dirks, Bristol & Co. moved to liquidate its clients' holdings in EFCA as rapidly as possible. Clearly, the rapid decision to abort further purchases of EFCA stock and instead to liquidate all clients' holdings in EFCA by Bristol & Co. was caused by its receipt of inside information regarding allegations of fraud at EFCA and knowledge of the circumstances surrounding the selective dissemination of such allegations.

Respondent The Dreyfus Corporation, as the findings herein show, also considered the inside information it received concerning allegations of fraud at EFCA to be material and sold the EFCA debentures of its client, DSIF, on the basis of such information. Before learning of the fraud allegations from Dirks, Dreyfus had placed a sell order for the EFCA debentures with Goldman, Sachs because Quinn considered the holdings inappropriate for DSIF. After learning from Goldman, Sachs that Dirks had a "story" about EFCA and that the market for the stock was unsettled, so that it could be sold only at a deep discount, Dreyfus suspended the sell order pending further checking with Dirks and others. After hearing the fraud allegations from Dirks by phone, Quinn formed the impression Dirks believed them to be true and he called Orphanos at home to have him follow up with Dirks to get further details. Quinn meanwhile decided to meet with Dirks in Los Angeles, since the former was going there on business in any event. Orphanos had a number of phone conversations with Dirks, in one of which he obtained the names and phone numbers of at least 4 former EFCA employees who purportedly knew about the fraud. Over the weekend of March 24-25 Orphanos spoke with ex-EFCA employees Secrist, Thibodeau, and Tickler.[48a] Based on all he had heard, Orphanos came to credit the truth of the fraud allegations and conveyed that view to Quinn. Orphanos reached this view notwithstanding contrary views received from Mercy at Goldman, Sachs and denials from

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[48a] See footnote 31a above.

EFCA's Levin and Arkus-Duntov. Quinn met with Dirks on the evening of March 25. The next day, having been unable to disprove the substantial evidence that the allegations of fraud at EFCA were true, and since Orphanos, in particular, tended to credit the truth of the allegations, Dreyfus sold the debentures. The decision to sell, which involved incurring a loss on an investment that had but recently been made, was motivated by the possession of inside information regarding the allegations of fraud at EFCA and the circumstances concerning the selective dissemination of those allegations.

Respondent Manning & Napier contends that its decision to sell the EFCA stock was made prior to Manning's talking with Dirks and for reasons that were independent of his receipt of inside information regarding the allegations of fraud. The record does not bear out this contention. Although Manning was indeed closely monitoring EFCA along with a half dozen or so other stocks for some time and had considered selling the stock for a week to 10 days prior to the actual sale, the record shows that the sale and the decision to sell were not in fact made until, as found herein, Manning came into possession of the inside information regarding the allegations of fraud at EFCA, including awareness of the market impact selective dissemination of the allegations was having. He responded to such inside information by selling.

The materiality of the specific allegations of fraud at EFCA as contrasted with the materiality of more vague "soft story" allegations is underscored by the disparate responses to the two allegations of Respondent Tomlin, Zimmerman & Parmelee, Inc., as disclosed by the findings above. TZP, after hearing a "soft story" from Dirks was persuaded on March 23 to purchase an additional 3,000 shares of EFCA, even though it considered that Dirks would continue selectively to disseminate that story. This decision was made in the belief that the soft rumors had had their maximum effect and that a substantial purchase would "wash out" the stock. Later, on March 26, after having heard from Dirks the "hard story," i.e. the report of allegations of insurance fraud at EFCA, and after

having come to the belief that Dirks would continue to selectively disseminate *those* allegations, TZP promptly liquidated all of its clients' EFCA holdings.

In support of the selling respondents' contention that the inside information concerning allegations of fraud at EFCA received by them was not "material", they rely heavily upon an argument that runs, in effect, as follows: (1) a number of entities, including the SEC the NYSE, the insurance departments or commissions of various states, the *Wall Street Journal*, and a number of individuals and private entities became aware of the allegations of fraud at EFCA; (2) they did not treat the allegations as "fact" or react to the allegations in a way that would have indicated they regarded them as material; and (3) therefore the allegations of fraud at EFCA that the selling respondents received were in fact and in law not material.

A number of considerations operate to deprive this argument of all but minimal weight.

First of all, as has been seen, the recognized test of materiality is the objective, reasonable-man test. Therefore an argument involving inductive reasoning predicated upon how given individuals or entities viewed particular factual situations is of very limited utility. (Compare pp. 113-4, 123-130 above, where the responses of selling respondents to the receipt of inside information are examined for a dual purpose.)

Secondly, Respondents' argument confronts the difficult task of establishing that the particular factual situation of individuals or entities upon whose reactions they would rely were in fact sufficiently analogous to those encountered by a selling respondent to be valid as an indicator. In a number of instances the record contains no such proof. Again, Respondents would have to show that the individuals or entities whose reactions are relied upon were in the posture of a "reasonable investor," a burden that in some of the reactions upon which they rely they are unable to sustain.

A third flaw in Respondents' argument is the aspect thereof that argues that the individuals and entities upon whose reactions they would rely did not view the allegations of fraud at EFCA "as a fact." This contends that to find materiality here the allegations of fraud would have to have been established as a fact. However, as concluded hereinabove in discussing the probability yardstick test as well as the market-impact and reasonable-investor tests of materiality, there is no rigid requirement that inside information be established as an incontrovertible fact, or anything close to that, before it can be found to be material. The inherent nature of the information and all relevant circumstances under which it is received must be taken into account.

As repsects the actions of the New York Stock Exchange the record shows that on March 22 Jarvis Slade and Saul Cohen of New York Securities reported to the Exchange that at a luncheon meeting of analysts an allegation of fraud at EFCA had been overheard. Dirks was not identified as the person reporting the allegations nor were details of the alleged fraud known or reported. The Exchange contacted EFCA management, which denied the allegation. On Friday, March 23, Goldblum personally met with Exchange personnel in New York City and strongly denied any and all rumors about EFCA, without focussing on the fraud allegations or identifying Dirks as the person reporting the allegations. At first, Exchange personnel tended to accept these denials by management, though they continued to monitor the stock price closely. Later, however, after learning *inter alia* that Dirks was reporting the fraud allegations, and after the Dow Jones Broad Tape carried a report on March 26th that heavy trading in EFCA was accompanied by rumors questioning the accuracy of EFLIC's insurance in force, coupled with appearance of an article of similar purport on March 27, in the *Wall Street Journal*, the New York Stock Exchange halted trading in EFCA. Significantly, the Exchange halted trading in EFCA in recognition of the market impact of the fraud allegations and without awaiting proof of the allegations "as a fact." In short, the Exchange

properly recognized the materiality of the fraud allegations even before certain events on March 30 made it appear highly probable that there was substantial truth to them.

The SEC first learned on March 9 that Secrist had taken his allegations of fraud at EFCA to the New York State Insurance Department. This occurred when an official of the California Insurance Commission met on that date with the Branch Chief of Investment Company Inspection in the Los Angeles Regional Office of the SEC to advise him that the California Commission had been advised of the Secrist allegations by the New York State Insurance Department. The information alleging fraud that was received by the SEC Branch Chief was substantially less detailed and less specific than what Dirks had received from Secrist. Unlike the situation of the selling respondents, the Branch Chief did not receive information that an experienced insurance analyst, Dirks, was reporting the Secrist fraud allegations or that the allegations had been received from more than one former EFCA employee. The Branch Chief tended to disbelieve the Secrist allegations and indicated that in any event SEC personnel were too busy on other matters to be able to assist California in investigating the matter for several months. The Branch Chief's memorandum concerning this meeting did not come to the attention of the Commission's Los Angeles Regional Administrator until Monday, March 26. However, after the Commission's Director of the Division of Enforcement in Washington, D.C. and officials in the Regional Office in Los Angeles were both informed on Friday, March 23, by Blundell of the *Wall Street Journal* that a number of former EFCA employees had alleged fraud at EFCA in talks with him, the Commission took prompt investigative steps that included, *inter alia*, interviews with Blundell on the 26th and interviews and depositions of Dirks, Hopper and Majerus on the 27th. On March 28, without any positive proof of the truth of the allegations of fraud at EFCA and without any certain knowledge as to what was causing the price of EFCA securities to fall, the Commission suspended trading in EFCA. The Commission did so recognizing that

whether the allegations of fraud were being made because of a belief in their truth or as part of a bear raid, and regardless of the truth or falsity of the allegations, the fact of their existence and their selective dissemination were clearly having a negative market impact on the price of EFCA securities. As was true of the NYSE's halt in trading, the Commission acted to suspend trading before the occurrence of certain events on March 30 that made the truth of the fraud allegations appear to be highly probable.[49]

William Blundell, Los Angeles Bureau Chief of the *Wall Street Journal*, first heard the report of allegations of fraud at EFCA from Dirks in a meeting between the two that lasted several hours on March 21. Dirks told him the substance of what he had heard by that time, and gave him names of former employees who might talk to him. Blundell followed up on the allegations personally rather than delegating the matter to a subordinate. After speaking with Secrist, Blundell began an investigation of his own that was to last about ten days and involve interviews of 14 to 20 persons. From March 21 through March 30 he devoted virtually all of his working hours plus some time of his own to investigation of this potential story. By Friday, March 23, he considered the information he then had of significance to the SEC. He thought the Commission might want to consider suspending trading in the stock. After getting Dirks' permission, he conveyed the information, as already found above, both to the Assistant Regional Administrator in

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[49] Late in 1971 an attorney in Los Angeles informed personnel of the Commission's Regional Office in Los Angeles that William Mercado, then an EFCA employe [*sic*], alleged *inter alia* that EFCA carried substantial fictitious insurance on its books. After some investigation and failure to find any supporting or corroborating data, the inquiry was dropped. Assuming, *arguendo*, that staff personnel failed to follow up the lead adequately or perseveringly enough, this would not establish Respondents' argument that such allegations of fraud are inherently incredible and therefore immaterial.

Los Angeles (the R.A. was home ill) and to the Director of the Division of Enforcement in Washington. Between March 21 and March 26 Blundell formed the belief that at least key parts of the fraud allegations were true ". . . after talking to a couple of people at Equity Funding who admitted to me that they had engaged in various criminal actions and who emotionally broke down about this thing." (R. 8702).

On March 26, after EFCA's Goldblum had been reported as denying the rumors about EFCA without being willing to identify the nature or substance of the rumors, Blundell submitted for publication on the Dow Jones Broad Tape at 4:16 p.m. on that day and in the *Wall Street Journal* on the morning of the 27th a brief, generalized characterization of the rumors, already referred to hereinabove (p. 105-6). These two reports stated that the heavy trading in EFCA was accompanied by rumors that centered on the accuracy of EFLIC's reported statements of new policies written and total insurance in force. These general and limited published characterizations of the nature of the rumors concerning EFCA were initiated by Blundell because he felt that in light of Goldblum's denial of the rumors while refusing to state their nature, the "reader", or the "public," was entitled to know at least that much about the nature of the rumors. Blundell commenced writing his detailed "expose" article concerning the EFCA fraud that appeared in the *Wall Street Journal* on Monday, April 2, on the previous Friday, March 30, when he learned that the Illinois Insurance authorities had discovered that $22 million of EFCA assets in the form of bonds supposedly deposited with a Chicago bank were in fact not there and had not been there for a considerable period. Also on March 30th, the California authorities seized EFLIC and Goldblum and Levin chose to exercise their 5th Amendment rights in projected testimony before personnel of the SEC.

When considered in the light of the proper tests for determining materiality, as discussed above, rather than under unsupportable criterion urged by Respondents—i.e. that the allegations of fraud at EFCA would have had to have

been established as fact beyond question (or at least have been universally accepted as fact)—it is clear from the foregoing findings that the reactions of the NYSE, the SEC, and Blundell of the *Wall Street Journal*, once they came into possession of information reasonably equivalent to that received by the several selling respondents, supports rather than negates a finding of materiality.

When Secrist reported his allegations of fraud to the New York State Insurance Department on March 7, the same day he met with Dirks[50] and Gorrelick, he set in motion a chain of reactions that ultimately involved the insurance departments of New York, California, Illinois, and New Jersey in investigating or making inquiry as to those allegations, since each of those states had jurisdiction to one degree or another over EFCA or one of its affiliates. Respondents urge that by and large these state regulatory officials gave little or no credence to the Secrist allegations and that none of them, including Illinois and California, which undertook a joint examination of EFLIC, uncovered any proof that the allegations of Secrist were "fact" until some time after the transactions involving the selling respondents occurred. From these premises, Respondents contend, it follows that the Secrist allegations were not material. Neither of the two prongs of this argument is valid. To treat the second point first, as already discussed extensively above, it is not necessary that inside information be established as proven "fact" or universally accepted "fact" for it to be material. As to the first point, the record shows clearly that the information concerning the Secrist fraud allegations available to the state regulatory personnel was a very long way from being comparable to the inside information that each of the selling respondents had available. In essence, the state regulatory personnel had nothing more than the

[50] As previously found, Dirks did not learn that Secrist had gone to a state insurance department on the East Coast until March 19.

allegations from Secrist (New York and Illinois personnel talked to him in face-to-face meetings while the others received his allegations indirectly in one degree of detail or another). For whatever reasons, the state regulatory personnel did not have the relevant statements of other ex-EFCA employees. Nor did they have the results of Dirks's marathon investigation of the fraud allegations or Dirks's evaluation of the results and import of his investigative activities. There is a significant difference between the allegations of one ex-employee and the totality of information the selling respondents had, including of course the overall circumstances in which they received it. Accordingly, it would be bootless to examine in detail the reactions of the state regulatory personnel since they were not operating on the same information that was available to each of the selling respondents.

Respondents also urge that the allegations of fraud at EFCA were not material because a number of other private persons and entities did not believe them to be, or treat them as, "fact." What has been said heretofore about the principle that materiality does not under the circumstances involved in this proceeding require that the fraud allegations be established as "fact" or universally accepted as "fact" is equally applicable with respect to this argument of Respondents. Moreover, except for persons or entities that were tipped by Dirks directly[51] and except for some officers or employees of EFCA referred to by Respondents, there is lack of satisfactory proof in the record that persons and entities referred to by Respondents had received inside information as extensive, detailed, or legally significant on the materiality issue as that received by selling respondents. As found elsewhere herein, Goldman, Sachs did not possess the same inside information that Respondent Dreyfus did, and there is no satisfactory proof in the record

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[51] As to why some of these "tippees" did not sell EFCA, the record is insufficiently developed to permit findings.

that Salomon Brothers possessed inside information of the nature, detail, or legal significance of that possessed by Bristol & Co. or other selling respondents. Additionally, as to certain entities referred to in Respondents' argument, a strong predisposition not to believe the allegations, quite apart from the nature of the inside information at hand, existed because of special ties to Goldblum or Levin of EFCA. Thus, J. Ira Harris of Salomon Brothers was a long-time acquaintance of Goldblum. Lawrence Tisch, of Loews Corporation, was introduced to Goldblum by Harris. Mercy, of Goldman, Sachs, was a long time personal friend of EFCA's Levin, with whom he talked frequently. Individuals such as these three, because of the special ties, had such strong faith in the integrity of Goldblum or Levin that their reactions to whatever inside information they had was not objective, and their reactions are therefore not significant on the issue of materiality. For somewhat analogous reasons, the fact that some high level officials of EFCA may have disbelieved or discounted the allegations of fraud, does not support Respondents' materiality argument.

Based upon the findings made herein, considered under the legal tests of materiality discussed herein, it is concluded that at the time of the relevant transactions each selling respondent was in possession of *material* inside information regarding EFCA and that in each case the inside information constituted either the only, or a significant, factor in each selling respondent's decision to liquidate its clients' EFCA holdings.

Bristol & Co.'s no-sale defense

Respondent Bristol & Co. concedes that its sale of the 600 shares of EFCA common stock from the Bristol & Co. Employees' Profit Sharing Plan settled in due course with Clark, Dodge & Co. and that it constituted a completed sale. However, respecting the transaction involving 457,200 shares of EFCA common stock, as to which Salomon Brothers refused delivery of the shares and out of which litigation resulted, and respecting the transaction involving $200,000 in face amount of EFCA convertible debentures with Loeb, Rhoades, which did

not settle and has remained open, Bristol & Co. defends on the ground that since there was no completed sale there can be no violation because there was no one to be "defrauded."

In examining this defense it should be noted that the conduct proscribed by Section 17(a) of the Securities Act is substantially identical to the conduct proscribed by Rule 10b-5 under the Exchange Act as pertinent here (see pp. 104-105 above) except that the reach of the respective provisions is in part different in that the former involves conduct "in the offer or sale of any securities" while the latter involves conduct "in connection with the purchase or sale" of any security."

The unsettled Bristol & Co., client transactions, whether or not they occurred in or in connection with a purchase or sale of securities, clearly involved an "offer"[52] of securities, defined in Section 2(3) of the Securities Act[53] to include "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." The inside-information rule is based as much on Section 17(a) of the Securities Act as it is on Rule 10b-5 under the Exchange Act.[54] Given the purpose and rationale for the inside-information rule—i.e. to protect the integrity and fairness of the securities markets and the public's faith and confidence in them—no reason is apparent why Section 17(a) does not proscribe offers in violation of the inside-information rule as much as it proscribes sales in violation of

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[52] By order dated October 12, 1977, the Division's motion to amend the Order for Proceedings in various particulars in order to conform the Order to the proof was granted. The principal effect of the amendment was to add an allegation that the violations alleged occurred "in the offer or sale" of EFCA securities to the previous allegation that the violations occurred in connection with the purchase and sale of EFCA securities.

[53] 15 U.S.C. § 77b.

[54] *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961); *Investors Management Co., Inc., et al.*, 44 S.E.C. 633 (1971).

the rule. The purpose and rationale for the development of the inside-information rule by the Commission and the courts are fully consistent with the purposes Congress had in enacting Section 17(a), in which it chose to attach the same consequences to offers in violation of the Section's terms as to sales in violation of the Section. Doubtless this was in recognition of the fact that sales frequently result from offers and that even when they do not, offers in violation of the Section can nevertheless have a deleterious effect upon the integrity of the securities markets. The instant situation well exemplifies this. Bristol & Co.'s effort to dispose of 457,200 shares of EFCA common at a discount of $1½ from the market price of $19 and its effort to dispose of $200,000 face amount of EFCA debentures clearly had an impact on the price of EFCA regardless of the fact that the sales did not ultimately settle. This means that sellers in the market sold for less than they would have if Bristol & Co. had not initiated its huge transactions. And, although an individual might be unable to recover from Bristol & Co. because of any of a number of reasons that are significant in litigation between private parties, this does not mean that in a disciplinary enforcement action such as this the Commission is unable to vindicate the public interest. It is well settled that a private litigant's remedy will not always be co-extensive with the Commission's broader enforcement powers as the agency designated by Congress to carry out the primary enforcement role under the securities laws.[55]

In addition, the "unsettled" transactions in EFCA securities initiated by Bristol & Co. on behalf of its clients constituted sales as defined in § 3(14)[56] of the Exchange Act, which defines the term "sale" to include "any contract *to* sell." (Emphasis added). When the EFCA common stock of Bristol & Co.'s clients was traded over the NYSE or crossed, in-house, Bristol

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[55] *Fridrich* v. *Bradford*, 542 F.2d 307, 320-21 (6th Cir. 1976).

[56] 15 U.S.C. § 78c(14).

& Co. had, through its selling broker, Salomon Brothers, concluded executory contracts to sell with Salomon Brothers' customers, Salomon Brothers' house account, and the numerous other ultimate purchasers set forth on Division's Exhibit 42, Schedule C. The Act's definition of sale as including a "contract to sell" does not concern itself with whether the contract to sell is void or voidable for fraud or any other reason or with whether there is ultimately an exchange of stock for value.

Similarly, when Bristol & Co. solicited and accepted Loeb, Rhoades' bid for the 200 EFCA debentures, it entered into an executory contract to sell within the meaning of the Exchange Act.

Cases relied upon by Respondent Bristol & Co. that require a settled or completed sale in private litigation presenting questions of standing to sue or the ability of a plaintiff to prove damages are simply not relevant in this disciplinary enforcement proceeding, where the Commission is vested with authority to vindicate the public interest in a much broader sense. As found above in discussing the "unsettled" transactions as offers under the Securities Act of 1933, the record contains ample evidence that such offers adversely affected the market for EFCA securities and therefore damaged participants in that market during the relevant period. The market and investors treated these trade-date transactions in EFCA the same as any other transactions in these securities, regardless of the fact that the trades did not ultimately settle.

As bearing in a general sense on the broad scope of the public interest that the Commission is required to vindicate, it is not without significance that Respondent Bristol & Co. seeks to avoid responsibility for any consequences flowing out of the unsettled transactions even though it was its own alleged misconduct that caused the intended sales to be aborted or not carried to fruition and even though it has itself never sought to rescind these contracts to sell.

The Division further contends that as respects some 20,000 shares of the 457,200 shares "traded" by Bristol & Co. on behalf of its clients the trades actually did settle.[57] The record contains uncontradicted testimony that this occurred—not through delivery or surrender of any stock certificates of Bristol & Co.'s clients, but through operation of the on-balance clearing and settlement procedure.[58] Salomon Brothers on the date in question evidently had other transactions in EFCA stock and in the balancing out or netting out process some 20,000 shares of EFCA stock got delivered to purchasers identified on Exhibit 42 as purchasers of the stock Bristol & Co. had agreed to sell on behalf of its clients.[59] These results were forseeable [*sic*] by Bristol & Co. and justify treatment of the transactions represented by the 20,000 shares as completed sales.

Lastly, as to this defense, the Division claims that Bristol & Co.'s participation in a settlement of litigation involving it and Salomon Brothers, among others, constitutes acknowledgement by Bristol & Co. that it did, at least *pro tanto*, engage in sales of EFCA stock on behalf of its clients. In view of the diverse reasons for which parties enter into settlements, and in view of the "clear and convincing" standard of proof being applied in this decision, no such inference is drawn here from the mentioned settlement.

Failure to disclose

The record establishes, as found herein, that each selling respondent failed to disclose material inside information prior

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[57] These included purchases by Lily Levy and Walter Rogers, who testified that they bought and paid for EFCA stock.

[58] See Stock Clearing Corporation Rule 8, NYSE Guide, CCH ¶ 3308.

[59] The record does not show precisely the source of these 20,000 shares of EFCA stock or whether there was any effort to reverse or rescind these settled sales after Salomon Brothers refused to accept delivery of EFCA stock from Bristol & Co.

to entering into the transactions that form the basis for its alleged violations. Only Respondent Dreyfus contends it did make proper disclosure. Respondents Dreyfus and Bristol & Co. contend they were not required to disclose because the other sides to their respective transactions already had substantially the same inside information these Respondents had.

As found herein (pp. 54-5 above) Quinn of Dreyfus conveyed to Mercy of Goldman, Sachs on Friday, March 23, the substance of certain allegations of fraud at EFCA that Quinn had heard on that date in a telephone conversation with Dirks. Mercy, as found above, expressed disbelief in the allegations, attributed to a "former employee" of EFCA, that EFLIC had put hundreds of millions of dollars of bogus insurance representing tens of thousands of fictitious policies on its books, had fraudulently re-insured the bogus insurance, and had issued phony death certificates as part of the scheme.

However, as found herein, Dreyfus did not disclose to Goldman, Sachs any information the former received in its continuing investigation into the matter subsequent to Quinn's conversation with Mercy of March 23. As found herein (see pp. 56-9 above), this information subsequently acquired by Dreyfus included significant elements of inside information going beyond that which Quinn had related to Mercy. Without repeating the previous findings in detail, certain significant items may be noted. Dreyfus learned subsequently in further conversations with Dirks that Don Goff, a *current* employee of EFCA, "confirmed" the alleged fraud. Dreyfus also obtained from Dirks the names and telephone numbers of four former EFCA employees with whom Dirks had spoken, including Secrist, his original informant. Over the weekend of March 24-25 Orphanos of Dreyfus personally telephoned Secrist and two other former employees of EFCA, Thibodeau and Tickler.[59a] Either by what they told him, or by how they re-

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[59a] See footnote 31a above.

sponded, these ex-employees tended to confirm the allegation of fraud at EFCA.

On the evening of Sunday, March 25, Quinn met with Dirks in Los Angeles. At this meeting Dirks told Quinn that Dirks had contacted additional employees since their last telephone conversation, who corroborated information he had gotten earlier, and that Dirks had begun to fear for his personal safety after having been cautioned by a representative of EFCA's former auditors. Dirks also told Quinn that he had arranged with Majerus and Hopper to meet with Blundell of the *Wall Street Journal*, to whom Dirks had relayed the allegations of fraud at EFCA, and that he had requested Majerus, former comptroller of EFLIC, to tell his story to a Mr. Balint, the partner-in-charge at Haskins & Sells, EFLIC's former auditors. Dirks advised that Majerus had called Balint.

These items of inside information acquired after the March 23 Quinn-Mercy phone call were all highly material, tending as they did to corroborate the earlier report of allegations, which attributed the allegations to a single ex-employee. They should have been disclosed to Goldman, Sachs.

Dreyfus argues broadly that Goldman, Sachs knew as much or more than Dreyfus knew about the allegations of fraud at EFCA. But there is no support for this contention in the record. There is nothing to support a finding that Goldman, Sachs was aware that 3 or more ex-employees and one current employee of EFCA all tended to confirm the fraud allegations, or that they were in possession of the other material inside information that Dreyfus acquired after the March 23 phone call. While there is evidence that Mercy made numerous phone calls to his friend Levin at EFCA regarding the rumors or allegations, there is nothing in the record to show that Goldman, Sachs as a result of such conversations or otherwise learned the material inside information that Dreyfus acquired after the March 23 phone call. Since Goldblum and Levin were "stonewalling" in response to all inquiries about the rumors, it seems highly unlikely that either would have furnished any

kind of detail regarding the allegations that could be construed as tending to corroborate them.

The Division also contends that even if Dreyfus had made adequate disclosure to Goldman, Sachs that would not have been enough. The Division contends that, even though Goldman, Sachs purchased the EFCA debentures from Dreyfus's client on a principal basis, the transaction cannot be regarded for disclosure purposes as comparable to face-to-face private transactions. This, the Division urges, flows from the fact that Goldman, Sachs during the relevant period was in effect functioning as a market maker in EFCA debentures and that Dreyfus was well aware that Goldman, Sachs was so functioning. Therefore, the argument concludes, public disclosure rather than disclosure merely to the purchaser was required.

While the Division's position on this point is considered to have great merit, particularly in light of the nature of the inside information here involved, it is unnecessary to rule expressly on the point in view of the conclusion reached herein that material inside information acquired by Dreyfus subsequent to the March 23 Quinn-Mercy phone call was not disclosed to the purchaser (Goldman, Sachs).

With respect to Bristol & Co.'s defense as regards its lack of disclosure, it must be noted at the outset that it is not claimed to be applicable to the 600 shares of common stock sold to Clark, Dodge & Co. or to the $200,000 face value convertible debentures contracted to be sold to Loeb, Rhoades. The defense applies only to offers or agreements to sell made to or through Salomon Brothers. The intended ultimate purchasers, including Salomon Brothers, some of its customers, and other broker-dealers or their customers, are shown on Schedule C of Division's Exhibit 42. The defense is that Salomon Brothers (and a few of its major customers) were as aware of the fraud allegations as Bristol & Co. was, that information possessed by Salomon Brothers would be imputed in law to ultimate purchasers for whom it acted as agent, and that there was thus no legal necessity for making disclosure to Salomon Brothers.

Bristol & Co. does not claim it was aware on March 26, the trade dates of the relevant transactions, that Salomon Brothers (or any of its clients) had the inside information.

The (partial) defense lacks merit for two major reasons.

First, the record does not substantiate the claim that Salomon Brothers (or its major customers) had material inside information of the same or substantially the same significance as Bristol & Co. had. While Salomon Brothers and some of its major customers were aware of the allegations of fictitious insurance at EFCA and that Dirks was the source of the allegations, and, indeed, had discussed the allegations with Goldblum and other personnel of EFCA, who denied they had any validity, there is no proof in the record that Salomon Brothers, *et al.* had the kind of corroborating details that increased likelihood that Bristol & Co. had. (Incidentally, Bristol & Co. did not call witnesses from Salomon Brothers to attempt to establish the nature or extent of their knowledge of the fraud allegations). For example, Bristol & Co., as found herein, was told by Dirks that he had talked to a number ("various") former employees of EFCA and that the situation did not look good (the inference would be that the various employees interviewed corroborated one another). Also, Bristol received a "recommendation" from Dirks to dispose of the stock, based on his by then lengthy and extensive investigation into the Secrist allegations. Furthermore, Bristol & Co. learned from Dirks that he expected an unfavorable *Wall Street Journal* report to come out imminently and that he also expected a trading halt or suspension in EFCA securities shortly. So far as the record shows, Salomon Brothers *et al.* had none of these significant, corroborative elements of material inside information—most of what they had by way of "inside" information were fervent but generalized denials from top EFCA management.

From a legal standpoint, too, Bristol & Co.'s partial defense respecting disclosure lacks merit. There is clearly no principle of law under which any knowledge Salomon Brothers may have

had can be imputed to the numerous ultimate intended purchasers in the transactions in which Salomon Brothers acted as agent for Bristol & Co. and traded on the NYSE with contra brokers acting for ultimate purchasers, e.g. Levy and Rogers.

Since Bristol & Co. had no understanding or reason to believe that Salomon Brothers was purchasing the EFCA stock for its own account, disclosure to Salomon Brothers alone would not have sufficed—full public disclosure was required before transactions could be entered into.[60]

Wilfulness, scienter, and related issues

Respondents contend that under the holding of the Supreme Court in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), a showing of scienter, i.e., "a mental state embracing intent to deceive, manipulate, or defraud" is required under both Sec-

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[60] In *Dupuy* v. *Dupuy*, 551 F.2d 1005, 1015 (5th Cir. 1977) the Court, in the context of a private suit presenting the question whether the plaintiff had exercised due diligence to protect himself against alleged fraud, in discussing the distinct requirements applicable in private suits as contrasted with enforcement proceedings, stated in part as follows:

> ". . . The dispositive element in these [the enforcement] cases is that the defendant owes a duty of full and fair disclosure to the public, not to any particular investor. Whether a private plaintiff might be precluded from recovery, then, need not alter the distinct consideration whether a defendant has violated duties imposed by the Act. . . ."

A commentator makes the point as follows:

> Since in any active market disclosure to a particular individual is not feasible, the duty to disclose, if such a duty exists, must be owed to all members of that ill-defined class of stockholders who, with the benefit of inside information, would alter their intention to [buy].

Painter, *Inside Information: Growing Pains for the Development of Federal Corporation Law Under Rule 10b-5*, 65 Colum. L. Rev. 1361, 1378 (1965).

tion 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act.

As to Section 17(a), it is concluded that Respondents' argument is not well founded. *S.E.C.* v. *World Radio Mission, Inc.*, 544 F.2d 535, 541 n. 10 (1st Cir. 1976); *contra, Sanders* v. *John Nuveen & Co., Inc.*, 554 F.2d 790 (7th Cir. 1977); *S.E.C.* v. *American Realty Trust*, 429 F. Supp. 1148, 1171 (E.D., Va. 1977). *The World Radio* court stated, in the footnote cited, as follows:

> 10. Defendants engage in a technical argument, that since the language of section 17(a) of the 1933 act is virtually identical to that of Rule 10b-5 and since *Hochfelder* read section 10(b) of the 1934 act, under which Rule 10b-5 was promulgated, as requiring scienter, section 17(a) must be similarly interpreted. This is a non sequitur. The *Hochfelder* Court recognized that Rule 10b-5(2), making it unlawful "to make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading," is not, by itself, limited to intentional deceit; but the Court held that the rule, if so interpreted, would exceed the authority of section 10(b) of the statute. 425 U.S. at 212-214, 96 S.Ct. at 1390-1391. Section 17(a), however, is a congressional enactment, not an SEC rule, and it contains the same language which the *Hochfelder* Court recognized did not require scienter. Thus, strictly speaking, since this action is founded on both section 17(a) and Rule 10b-5, we need not decide what result would obtain in an SEC injunction action based solely on section 10(b) and Rule 10b-5—though we do think it implausible to suppose that Congress intended to provide a mechanism for the SEC to protect the public from the injurious schemes of those of evil intent and yet leave the public prey to the same conduct perpetrated by the careless or reckless.

Although *World Radio* was a suit for injunction, its rationale on the point at issue is equally persuasive in enforcement proceedings such as this. Moreover, the rationale applies both

to the second and third numbered clauses of Rule 10b-5 and Section 17(a), respectively. See *Hochfelder*, *supra*, 425 U.S. at 212. The reasoning of *World Radio* and the clear implications of *Hochfelder* itself are persuasive and are not negated or attenuated by any of the contrary holdings. Further authority supporting this conclusion as to Section 17(a) is found in *Steadman Securities Corp., et al.* [current] Fed. Sec. L. Rep. (CCH) ¶ 91,243 (Investment Company Act Release No. 9830, June 29, 1977), *appeal pending* (5th Cir.); 12 SEC Docket 1041, July 12, 1977.

As to Rule 10b-5, *Hochfelder*, *supra*, was silent as to applicability of the scienter requirement to SEC administrative enforcement proceedings, though it expressly reserved judgment as to its applicability to SEC injunctive suits. The Commission in *Steadman*, *supra*, concluded that proof of specific intent to defraud was not required by *Hochfelder* in SEC disciplinary enforcement proceedings.

Since the Commission there found the "scienter" requirement to have been met, conclusion was technically dictum; nevertheless its treatment of the issue suggests the Commission intended it as a definitive statement of its position.

The only judicial decision offering any view on the issue in a disciplinary proceeding is *Arthur Lipper Corp.* v. *S.E.C.*, 547 F.2d 171, 180-81, n. 6 (2d Cir. 1976) *rehearing denied* March 22, 1977, 551 F.2d 915, *certiorari denied*, 46 U.S.L.W. 3429 (Jan. 10, 1978). There the Court assumed, *arguendo*, without deciding, that the *Hochfelder* culpability standard was applicable to SEC disciplinary enforcement proceedings but, since it concluded that on the facts that standard had been met, the Court found it unnecessary to decide the point.[61]

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[61] Judge Friendly, writing for the Court, seemed to express a leaning in favor of a view that *Hochfelder* does apply to SEC administrative enforcement proceedings. However, the language quoted from the opinion in *World Radio*, *supra*, would seem to suggest a

In the instant proceeding it is likewise not necessary to decide whether the *Hochfelder* scienter requirement applies under Rule 10b-5. This is so for two reasons. Firstly, the findings herein establish that the culpability standard of *Hochfelder* has been met, and, secondly, if a reviewing tribunal should conclude that intent to deceive within the meaning of Rule 10b-5 had not been established, violations as charged would nevertheless be established under Section 17(a), under which intent to deceive need not be established.

In determining what the proper standard of culpability was in an SEC administrative disciplinary proceeding under an assumption of *Hochfelder's* applicability, Judge Friendly in *Lipper* wrote in part as follows (547 F.2d at 181):

> Putting aside for the moment the defense of reliance on the advice of counsel, we do not regard the *Hochfelder* decision as carrying the day for petitioners. The Court held that in order to create liability for damages under Rule 10b-5—and we assume in petitioners' favor that the same standard governs proceedings under §15, see fn. 6—there must be proof of intention "to deceive, manipulate, or defraud" — not in intention to do this in knowing violation of the law. The Court reasoned that the language of §10 suggested that the section "was intended to proscribe knowing or intentional misconduct," 425 U.S. at 197,

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belief that Congress could not have intended the *Hochfelder* culpability requirement to apply to Section 10(b) enforcement actions since it provided otherwise (as the Court concluded) with respect to Section 17(a), whose provisions are substantively identical to those of Rule 10b-5. Conceivably the ruling in *Hochfelder* could come to be narrowly applied to its facts, i.e. cases involving private litigants relying on a judicially-inferred right to sue, since a substantial measure of the Court's reasoning in *Hochfelder* depends upon statutory provisions for private litigants in other sections of the Exchange Act.

96 S.Ct. at 1383.[7] It thought that use of such words as "manipulative," "device," and "contrivance" made "unmistakable a congressional intent to proscribe a type of conduct quite different from negligence," 425 U.S. at 199, 96 S.Ct. at 1384. And it referred, 425 U.S. at 202, 96 S.Ct. at 1385 to the oft-cited testimony of a sponsor of the Act before the House Committee on Interstate and Foreign Commerce that what became §10(b) says "Thou shall not devise any other cunning devices." While that phrase could not be regarded as including negligence, it reads precisely on what petitioners did here — charging the full NYSE commission rates on IOS generated OTC transactions and rebating half of these to IPC, a subsidiary of IOS, knowing that IPC would retain the sums paid to it although these should have been turned over to the funds directly or applied to reduce the advisory fee. It is no answer that petitioners may not have realized that this "cunning device" was a fraud.

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7. Indeed, even in the criminal context neither knowledge of the law violated nor the intention to act in violation of the law is generally necessary for conviction. The first proposition seems implied by the rule *ignorantia juris non excusat*. Hall, Criminal Law 288 (2d ed. 1961). And the second, of course, follows from the first. Perkins, Criminal Law 745 (2d ed. 1969). See ALI, Model Penal Code §§ 1.13(12), 2.02(2)(a) & (b); *Ellis* v. *United States*, 206 U.S. 246, 257, 27 S.Ct. 600, 602, 51 L.Ed. 1047 (1907), where, in rejecting a claim that knowledge of the law was required for conviction under a statute that included the word "intentionally", Justice Holmes said, "If a man intentionally adopts certain conduct in certain circumstances known to him and that conduct is forbidden by the law under those circumstances, he intentionally breaks the law in the only sense in which the law ever considers intent." [Remainder of footnote omitted.]

In the instant proceeding the record and the findings establish that each selling respondent acted entirely or in material part on the basis of material inside information concerning fraud at Equity Funding in selling, offering to sell, or agreeing to sell, EFCA securities to known or unknown purchasers without disclosing to such purchasers the inside information in its possession. In each case the decision to sell, offer, or agree

to sell was knowing, deliberate, and intentional, not inadvertent or negligent. In each case the decision to withhold the inside information from purchasers or prospective purchasers rather than to disclose it was knowing, deliberate, and intentional, not inadvertent or negligent. The fact that each selling respondent acted in whole or in material part on the basis of the inside information, under circumstances found herein, indicates its awareness that the inside information was material. It was clear that the information was from inside sources. And Respondents were well aware of the long-settled law that selling on the basis of material inside information without proper disclosure is a fraudulent or deceptive act, practice, or course of business. Thus, their knowing, intentional commission of such an act or practice itself evidences an intent to deceive the purchasers. Intent to deceive is inherent in the nature of the offense, absent inadvertence or good faith considerations.

The Commission in *Steadman*, *supra*, 12 S.E.C. Docket at p. 1051, found an intent to deceive under the following analysis:

What we have here is:

(1) a duty to reveal; plus
(2) an intent to conceal; and
(3) actual concealment.

These elements are all present in the instant proceeding.

Likewise, the findings made herein more than meet the culpability standards applied by the Court in *Lipper*, *supra*, under its assumption of *Hochfelder's* applicability to administrative disciplinary proceedings brought by the Commission. In *Lipper*, Judge Friendly concluded that "[i]t is no answer that petitioners may not have realized that this 'cunning device' was a fraud." *Supra*, 547 F.2d at 181.

Respondents contend they could not have had the requisite intent to deceive because they did not believe the allegations of fraud at EFCA. However, as developed above, under the "probability yardstick" test for materiality, it is not necessary

that an allegation having significance be established as fact or universally believed before it becomes material. As already noted, each selling respondent did in fact act on the basis of inside information and the fact of having acted on the basis of the information itself evidenced recognition of its materiality. Respondents' argument that they did not recognize the materiality of the inside information they acquired is therefore not persuasive. Thus selling Respondents knew or should have known they would be committing a wrongful act, a deception of the purchasers, if they failed to disclose the inside information each had. Moreover, under *Lipper*, knowledge that they were acting in contravention of law would not be required to satisfy the scienter requirement.

The argument of some Respondents that they believed the inside information they had was already public knowledge is so lacking in support in the record as to come close to being frivolous.

Respondents contend they acted in good faith because state insurance laws and libel laws prohibited publication or dissemination of the allegations of fraud at EFCA and that they lacked other means of ensuring that the allegations became public, while their fidcuiary [*sic*] obligations compelled them to sell in the face of falling EFCA prices and circulating allegations of fraud.

The "dilemma" erected by Respondents in [*sic*] illusory, a chimera.

It is settled law that a trustee's obligations to his or its beneficiaries do not require the commission of an illegal act. See Scott, *Trusts*, §§ 61, 166 (3d. ed. 1967). The Commission has stated in *Investors Management Co., Inc., et al.*, 44 S.E.C. 633, at p. 647 (1971), in pertinent part as follows:

> . . . The obligations of a fiduciary do not include performing an illegal Act [*sic;* footnote citations omitted] . . . And there is no basis for the stated concern that a fiduciary who refrains from acting because he has received what he believes to be restricted information would be held dere-

> lict if it should later develop that the information could in fact have been acted upon legally. If that belief is reasonable, his non-action could not be held improper.

Cady v. *Roberts*, 40 S.E.C. 907, 916 (1961) is to the same effect.

Under the facts in the instant proceeding, Respondents would have been justified, indeed required, to refrain from trading in the absence of a proper disclosure. In view of this it is unnecessary to consider whether State insurance laws precluded disclosure (on their face, some of the statutes cited appear not to be germane) or the effect of libel laws. Likewise, it is unnecessary to consider whether other avenues for getting the requisite disclosure made were closed to Respondents. In passing, it may be observed that Respondents made no effort to contact the NYSE[,] the SEC, or any other regulatory body that might have been in position to require or influence EFCA to make proper discosure [*sic*] of the allegations of fraud at EFCA.

Respondents III, Bristol & Co., and Dirks urge reliance upon advise [*sic*] of counsel as evidence of good faith.

The Commission holds that reliance upon advice of counsel may be used in mitigation on the issue of sanctions but cannot make unlawful conduct legal. *Arthur Lipper Corporation*, Securities Exchange Act Release No. 11773, October 24, 1975, at p. 16, n. 41, *affirmed in part, reversed as to sanctions*, *Arthur Lipper Corp.* v. *S.E.C.*, 547 F.2d 171, 181-2[82] (2d Cir. 1976), *cert. den.*, 98 S.Ct. 719 (1978).

Apart from the legal effect of reliance upon advice of counsel in appropriate circumstances, it is clear from the facts found

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[82] In rejecting petitioners' contention of reliance on counsel, the Court concluded the defense was not available because counsel was unable to give wholly disinterested advice and therefore found it unnecessary to consider the Commission's ruling on the point.

herein that none of the three claimants establishes good faith reliance upon advice of counsel.

III, which sought legal advice after it first heard something of the fraud allegations from Dirks, materially misinformed Attorney Evans of the recency of the informant's employment with an EFCA affiliate. In a second phone call, on March 14, Courtney failed to tell Evans about the fact of and substance of Courtney's long face-to-face discussion with Dirks and Gorrelick on the following day. III never re-checked with Evans after III collected additional corroborative information from continued contacts with Dirks and as a result of other extensive checking III did. Moreover, III breached Evans' admonition not to contact EFCA directly *or indirectly* by talking to EFLIC's re-insurers and to Dirks, who talked to additional EFCA ex-employees, i.e. Hopper and Majerus. In short, III's attempt to obtain a legal opinion was perfunctory. Evans never received the full information required to enable him to render an informed opinion and his caveat was not fully observed. In these circumstances III's claim of good faith reliance upon the advice of counsel is not substantiated.

Bristol & Co.'s claim to reliance in good faith upon advice of counsel is even less well founded than that of III. Bristol & Co. relies upon the fact that on March 23 III's Baker told Bristol & Co.'s Smith that III had sought and obtained an oral legal opinion and guidelines from Evans. Bristol & Co. was unaware of what "facts" III had given or failed to give Evans as the basis for his legal opinion. In any event, the "facts" confronting III when it sought legal advice were not the "facts" confronting Bristol & Co. when it should have sought a legal opinion of its own. Dirks told Bristol on Monday, March 26, that he had talked to various EFCA employees over the weekend—*after* III had liquidated on the 21st—and that what he had heard "was not good" and that if Dirks were in Bristol's position he would sell the EFCA stock. In addition Bristol formed the impression from his conversation with Dirks that the *Wall Street Journal* would soon be coming out with an unfavorable story on EFCA. In addition, Dirks told Bristol he doubted

trading would continue in EFCA securities because Dirks had talked to the former auditors, Haskins & Sells, and had prevailed upon the former Comptroller of EFCA [Majerus] to talk to Haskins & Sells about the fraud allegations. All of these were significant elements of information that Bristol & Co. had that III could not have had when it sought Evans's legal opinion. Moreover, Bristol & Co. violated the "guidelines" Evans had given III by talking directly to Levin and Arkus-Duntov, two top level officers of EFCA, in an attempt to obtain confirmation or denial of the fraud allegations. In view of these deficiencies and other relevant circumstances, Bristol & Co. can hardly claim reliance in good faith upon advice of counsel.

Dirks's asserted good-faith reliance upon the advice of counsel is clearly contradicted by the record. He contends that on March 14 and again on March 21 he was told by personnel of III that III had informed its counsel [Evans] of the Secrist allegations in detail and had been advised that the fraud allegations were not covered by the inside information rule and that Secrist was not an insider. There is no indication in the record that III led Dirks to believe that it had sought or obtained any legal opinion subsequent to March 14. As the findings herein abundantly evidence, Dirks kept receiving additional inside information from additional insiders subsequent to March 14 and through March 26 on a continuing basis, and he selectively disseminated such information during that period. Obviously an opinion rendered on the basis of information available as of March 14 would not necessarily be valid on the basis of "facts" Dirks kept accumulating thereafter, and he had no reason whatever, as a sophisticated and experienced analyst, for supposing that it would.

Dirks also relies on his having disclosed the Secrist fraud allegations to Richard Weiss, an insurance lawyer whom Dirks had on occasion engaged, without receiving from Weiss any reaction or advice that this was inside information. The disclosure occurred in a chance meeting on March 19, before Dirks took off for Los Angeles to pursue his investigation in greater earnest. Weiss was neither asked for, nor did he volunteer, an

opinion as to whether the Secrist allegations of fraud were inside information. Dirks relies on Weiss's silence as indicating that everything was all right. The record does not indicate that Weiss was qualified or experienced in securities law so that he could have rendered a reliable opinion had one been requested. And, of course, as indicated with reference to the Evans legal advice, even if Weiss had rendered an opinion on the 19th, it would not have held good without further consultation in light of the significant additional inside information Dirks acquired from other inside sources after March 19th and through March 26th. Dirks is far too experienced and sophisticated to have been under any good faith belief that he had any basis for relying upon "advice of counsel" upon either of the bases discussed above.

Respondent Dirks also urges that his gathering of information concerning the allegations of fraud at EFCA and his selective dissemination thereof are protected by the free speech provisions of the First Amendment to the Constitution. The argument lacks merit.

The findings herein make it clear that Dirks was involved in such activities not as an agent of the press or as a free-lance newsgatherer but in his capacity as an analyst of insurance company securities. Thus, if Dirks is to gain any comfort from the First Amendment it must come from the cases applying the First Amendment to commercial speech.

But the law is clear that the protection afforded to commercial speech is not absolute — that it does not remove a business engaged in the communication of information from general laws regulating business practices. The principle was well stated in *Savage* v. *C.F.T.C.*, 548 F.2d 192, 197 (7th Cir. 1977), where the Court stated in pertinent part:

> Commercial speech is entitled to a measure of First Amendment protection, *Virginia State Board of Pharmacy* v. *Virginia Citizens Consumer Council*, 425 U.S. 748, 96 S.Ct. 1817, 48 L.Ed. 2d 346 (1976), but it has long been recognized that the Amendment does not remove a business engaged in the communication of information from

general laws regulating business practices. As Justice Harlan stated in *Curtis Publishing Co.* v. *Butts*, 388 U.S. 130, 150, 87 S.Ct. 1975, 1989, 18 L.Ed.2d 1094 (1967):

> "A business 'is not immune from regulation because it is an agency of the press. . . .' Federal securities regulation, mail fraud statutes, and common-law actions for deceit and misrepresentation are only some examples of our understanding that the right to communicate information of public interest is not 'unconditional.' " (Citations and footnotes omitted).

Dirks argues that there was a "significant public interest" in the allegations of fraud at EFCA. Of course there was. And Rule 10b-5 and Section 17(a) are designed among other things to ensure that the public at large will obtain access to such information since it is material to investment decisions. But the effect of Dirks's activities at least in the short term was to give such information not to the public at large but selectively to a small fragment of the investing public. Dirks's argument would turn violation of law into virtue.

Dirks also urges in connection with his First Amendment defense that judicial decisions applying it hold that its protection is unavailable only if he acted in violation of law with scienter. The cases relied upon are, in my view, misconstrued or misapprehended. However, since the findings herein conclude that Dirks did act with the requisite scienter to support findings of the charged violations, it is unnecessary to discuss these particular First Amendment cases.

As found herein, Dirks disseminated the allegations of fraud at EFCA selectively in the expectation and belief that most of the recipients of the information would act on it and sell their EFCA holdings. He continued to disseminate such inside information after he had received strong indications that at least two recipients of the information had acted on it to sell substantial quantities of EFCA securities. On these and on all the findings affecting Dirks it is concluded that he acted in the expectation, and with the intent, that a percentage of the recipients of the inside information would act upon it and liquidate their EFCA holdings.

Dirks's motivations for the selective disseminations were twofold. Firstly, he hoped that his selective disclosures, by depressing the price of the EFCA securities, would be instrumental in leading to exposure of what he believed, as previously found herein, was probably a fraud at EFCA. Secondly, the selective dissemination was expected by Dirks to develop good will towards him and his brokerage firm among actual or potential clients for his services as an analyst. With respect to III, as found, it actually resulted in commission business for his firm.

That Dirks concurrently with his selective dissemination to others also disclosed the inside information to *Wall Street Journal* reporters and urged them in effect to print the allegations does not negate his intent or scienter with respect to the selective disclosure to others. Dirks proceeded on two tracks, both heading towards the same result — ultimate exposure of what he believed was probably a fraud. Had Dirks confined his disclosures to the *Wall Street Journal* reporters (or had he gone to cognizant regulatory or self-regulatory bodies) instead of also disclosing selectively to investors, he might indeed have been perceived as the public-spirited hero he seeks to portray himself as in this proceeding. He chose, instead, to employ the two-track pattern he in fact employed out of a belief, as evidenced by the entire record and observation of Dirks and other witnesses, that these methods would give him higher visibility and greater public recognition as an analyst and an opportunity at the same time to develop direct good will and potential future clients as respects the firms to whom he selectively disseminated the inside information.

If the record did not establish, as found herein, that Dirks acted with the expectation and intent that a number of the tippees to whom he selectively disclosed inside information concerning the EFCA fraud allegations would act on such information, it would at the very least establish that he acted in reckless disregard of the foreseeable consequences of his campaign of selective disclosure.

Respondent Dirks also contends in effect that for him to be found to have wilfully aided and abetted violations by the selling respondents it must be established (1) that his conduct would not subject him to primary liability for violation of Rule 10b-5 or Section 17(a); (2) that a selling respondent committed a violation as charged; (3) that Dirks knew that his role was part of the overall fraudulent activity leading to a violation by a selling respondent; (4) that Dirks acted with the specific intent to defraud; and (5) that Dirks substantially assisted the violation.

Contention (1) above is made on the premise that since *Texas Gulf Sulphur, supra*, 401 F.2d 833, 852-3 establishes that a "tipper" such as Dirks may be primarily liable for a Rule 10b-5 violation he cannot logically be "secondarily" liable as an aider and abetter for the same acts or conduct. Evidently Dirks makes this point out of concern that some lesser level of culpability may apply to aiding and abetting than applies to "primary" violations. In *Texas Gulf*, a suit for injunction, the tipper was held to have violated Rule 10b-5. His tippees were not parties to the suit, though there was a finding that some acted on the basis of the "tips".

In the instant disciplinary enforcement proceeding, it would seem that Dirks's conduct more properly constitutes an aiding and abetting although, logically, contrary to Dirks's contention, there is no reason why the tipper's act, if tipping is itself a violation under applicable case law, could not also be an aiding and abetting where the facts and law warrant such findings and conclusion.

In any event, it is clear from the findings herein that all of Dirks's suggested criteria for finding an aiding and abetting violation are met here. Dirks clearly substantially assisted the violations by selling respondents — indeed he put into motion the whole chain of events that resulted in such violations. Dirks was also well aware that his role was central to the violations by others — as found herein he was aware that others had sold on the basis of fraud allegations conveyed by him and he

expressly advised Bristol that if he were in his situation he would sell the EFCA securities. Moveover [*sic*], Dirks expected most of his tippees would sell and wanted them to do so in order to achieve his purpose of exposing what he believed to be a probable fraud at EFCA. Dirks knew that the clearly foreseeable consequence of his disclosures of material inside information was that purchasers would be defrauded and he was willing to have that occur as the price of exposing the probable fraud and advancing his own interests with actual or potential clients. Thus, he intentionally aided and abetted the defrauding of purchasers (and of the investing public generally).

Conclusions of law

In general summary of the foregoing, it is concluded that during March of 1973, the indicated respondents committed violations of the following provisions of law or rule as a result of the following acts, practices, and failures to disclose, all as more particularly found above:

(1) On particular dates in March, 1973, as more particularly found above, Respondents The Boston Company Institutional Investors, Inc., John W. Bristol & Co., Inc., The Dreyfus Corporation, Manning & Napier, and Tomlin, Zimmerman & Parmelee, Inc. wilfully violated Section 17(a) of the Securities Act of 1933, as amended, 15 U.S.C. §77q(a), Section 10(b) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. 78j(b) and Rule 10b-5 thereunder, 17 CFR § 240.10b-5 through use of jurisdictional means, by selling, or by offering and agreeing to sell, securities of Equity Funding Corporation of America for their clients on the basis of material, non-public inside information concerning allegations of fraud at Equity Funding obtained from Respondent Raymond L. Dirks and others without disclosing such inside information to purchasers, potential purchasers, or the investing public.

(2) During March of 1973, as more particularly found above, Respondent Raymond L. Dirks wilfully aided and abet-

ted violations of Section 17(a) of the Securities Act by Respondents mentioned in paragraph (1) next above and wilfully violated and wilfully aided and abetted violations by such Respondents of Section 10(b) of the Exchange Act of 1934 and Rule 10b-5 thereunder, through use of jurisdictional means, by receiving and obtaining and selectively disclosing to said Respondents and to others material, non-public inside information concerning allegations of fraud at Equity Funding.

III

THE PUBLIC INTEREST

In determining what sanctions, if any, it is appropriate to apply in the public interest, it is necessary for the Commission, among other factors, to ". . . weigh the effect of . . . action or inaction on the welfare of investors as a class and on standards of conduct in the securities business generally."[63]

It does not appear that any of the Respondents has been the subject of prior disciplinary action. The principals of the selling respondents, and the firms themselves, enjoy good reputations. All selling respondents have incurred substantial legal costs, some significantly greater than others, in connection with defending this proceeding, and in private litigation, including both individual suits and class actions. The Boston Company, parent of III and Bristol & Co., incurred some $3.5 million in legal and related costs as a result of its Equity Funding involvement, of which 45% was allocated to Bristol & Co. and the balance to other subsidiaries. Class actions in the United States District Court arising out of the Equity Funding

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[63] *Arthur Lipper Corporation*, Securities Exchange Act Release No. 11773 (October 24, 1975) 8 SEC Docket 273, 281. Although [*sic*] the reviewing Court in *Arthur Lipper Corp.* v. *S.E.C.*, 547 F.2d 171, 184-5 (2d Cir. 1976) reduced the Commission's sanctions on its view of the facts, it recognized that deterrence of others from violations is a ligitimate [*sic*] purpose in the imposition of sanctions.

situation were settled for $60 million, toward which certain of the selling respondents, including Dreyfus, contributed $4 million.

Certain respondents urge that they lost customers and business that they have never recovered, but proof that this resulted from their having traded Equity Funding securities is not adequately established.

The Boston Company, parent of III and Bristol & Co., has a new chief executive officer who, in his testimony at the hearing, conveyed an impression of special sensitivity to proper recognition of the public investors' rights in matters such as insider trading.

Dreyfus states in its brief, and this is accepted as established for the purpose of assessing sanctions, that it has introduced an improved and effective system of compliance, including procedures for making counsel readily available to persons in the firm having to make transaction decisions that could involve inside information problems.

As to Dreyfus, account is also taken of the fact that although it did not disclose to Goldman, Sachs, all of the material, inside information it received, or make overall legally effective disclosure, it did disclose a significant amount of inside information to Goldman, Sachs. While Dreyfus had no legal basis for assuming it had made proper disclosure, its failure to make full disclosure is perhaps more understandable in light of the partial disclosure that was made and of the overall circumstances involving its transaction.

The argument made by several respondents that no sanction should be applied because of the Division's effort at "selective enforcement" is not accepted. There is no basis in the record for concluding that the Division or the Commission improperly selected Respondents to be proceeded against while failing to include others equally culpable.

Respondent Dirks was less than candid in his testimony in this proceeding, particularly as respects the degree of his

alleged disbelief of the allegations of fraud at EFCA at various stages of his investigation. Moreover, in suggesting that his investigation and selective dissemination of the allegations of fraud at EFCA were just a part of his normal functions as an insurance company analyst, Dirks evidences a lack of appreciation for the fundamental purpose underlying the insider trading rule. And, as the findings indicate, Dirks was an indispensable and knowing actor in the violations committed by the selling respondents. Dirks's argument that he should be given credit for having "exposed" the EFCA fraud has already been discounted in the findings above, in view of his mixed motives.

Dirks urges that as a result of his Equity Funding investigation he was fired from his job and kept out of his profession for about a year. Although he so testified, at other points in the record it appears that he may have taken a year off to write a book concerning his exposé. At any rate, he has not had difficulty obtaining a number of employments in the securities industry since that time. Dirks also claims he was thwarted in his efforts to become a registered investment adviser by "threats" that an administrative proceeding would be immediately mounted against him if he applied for registration.

In overall terms, the record indicates that on the whole Dirks sustained less (if any) financial loss or loss of reputation as a result of his involvement with the Equity Funding matter than did the selling respondents. And, of equal significance, selling respondents appear to have learned more from the experience in terms of future caution than has Dirks.

Taking into account the nature and extent of the violations, mitigating circumstances, and the record as a whole, it is concluded that the sanctions ordered below both for remedial and deterrent purposes are necessary, appropriate and adequate in the public interest.

IV

ORDER

Accordingly, IT IS ORDERED as follows:

(1) Respondent Raymond L. Dirks is hereby suspended from association with a broker or dealer for a period of sixty days.

(2) Respondents The Boston Company Institutional Investors, Inc., John W. Bristol & Co., Inc., Manning & Napier, and Tomlin, Zimmerman & Parmelee, Inc. are hereby censured.

(3) The imposition of a sanction is not deemed to be necessary in the public interest in the case of Respondent The Dreyfus Corporation.

This order shall become effective in accordance with and subject to Rule 17(f) of the Commission's Rules of Practice, 17 CFR §201.17(f).

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party that has not, within fifteen (15) days after service of this initial decision upon him or it, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him or it. If a party timely files a petition for review, or the Commission takes action to review as to a

party, the initial decision shall not become final with respect to that party.[64]

/s/ _____
David J. Markun
Administrative Law Judge

Washington, D.C.
September 1, 1978

[64] All proposed findings, conclusions, and supporting arguments of the parties have been considered. To the extent that the proposed findings and conclusions submitted by the parties, and the arguments made by them, are in accordance with the findings, conclusions and views stated herein they have been accepted, and to the extent they are inconsistent therewith they have been rejected. Certain proposed findings and conclusions have been omitted as not relevant or as not necessary to proper determination of the material issues presented. To the extent that the testimony of various witnesses is not in accord with the findings herein it is not credited.